# Economic Outlook and Fiscal Review

## ONTARIO 1988

Ministry of
Treasury and
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# *Preface*

In Spring 1986, the Legislature set up the Standing Committee on Finance and Economic Affairs to "consider and report to the House its observations on the fiscal and economic policies of the Province." The 1988 Economic Outlook and Fiscal Review is part of the Government's efforts to assist the Committee in its endeavours and to enhance the general process of public consultation leading to the development of the 1989 Ontario Budget.

# *The Ontario Economic Outlook*

**Ontario Economic Outlook at a Glance**

| | 1987 | 1988 | 1989 |
|---|---|---|---|
| Real Growth (%) | 4.4 | 4.5 | 2.9 |
| Inflation (%) | 5.1 | 4.7 | 5.1 |
| Job Creation (000s) | 151 | 180 | 105 |
| Unemployment Rate (%) | 6.1 | 5.0 | 5.0 |

Ontario is entering its seventh consecutive year of economic growth.

Driven largely by business investment, the economy should continue to expand in 1989. The rate of growth will be more moderate and sustainable, with real Gross Domestic Product increasing by 2.9 per cent. Smaller employment gains and a stable savings rate will restrain spending growth compared to the last few years.

The economy will nevertheless generate over 100,000 new jobs in 1989. Unemployment will average 5.0 per cent -- unchanged from 1988, and the lowest level since 1974.

Inflation will remain stable, rising only slightly to 5.1 per cent.

## Ontario Economic Outlook: Towards Sustainable Growth

### Recent Performance: Growth Continues

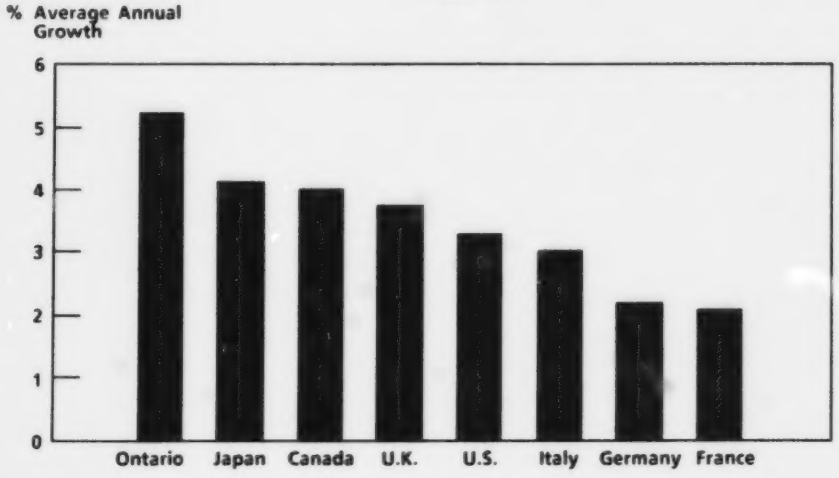
The current economic expansion has continued without interruption for 24 quarters. It is now the second longest expansion since 1950, surpassed only by the 52-quarter period of growth between 1961 and 1973. Over the past six years, real output in Ontario has expanded by 42 per cent. Employment has increased by 860,000 jobs.

Ontario emerged from the 1981-82 recession with substantial unemployed labour and plant capacity, significant pent-up demand for consumer durables and housing and a high level of savings. These factors have made possible the rapid growth in output and employment to this point in the expansion.

Spare capacity has now been absorbed and the savings rate has declined to its lowest level since 1971. As a result, a transition to more moderate and sustainable growth is underway.

Ontario had fully recovered from the recession by 1984. Since 1985, real output in Ontario has grown by an average 5.2 per cent a year, and employment has increased by 3.6 per cent annually. In both output and employment terms, Ontario has experienced higher growth than any of the major industrialized countries.

**INTERNATIONAL COMPARISON OF REAL OUTPUT GROWTH**
**1985-1988**



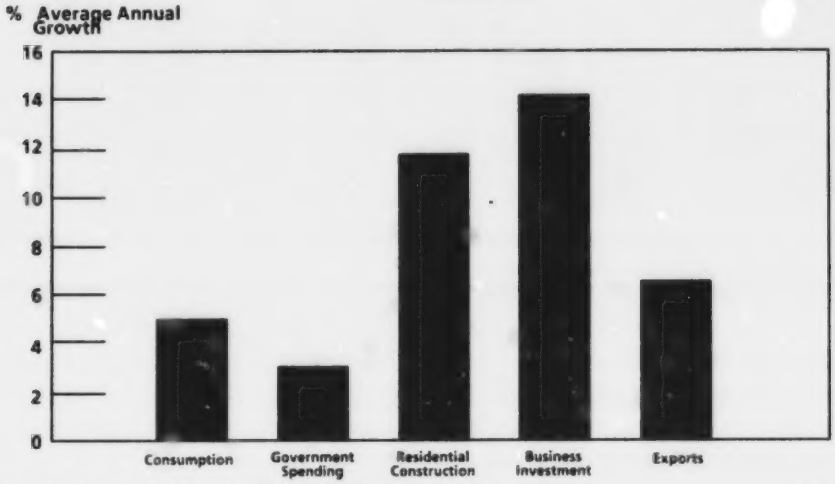

Source: International Monetary Fund, Statistics Canada and Ontario Ministry of Treasury and Economics.

During the 1983-1984 period, consumer spending and exports were the fastest growing components of aggregate demand. By contrast, in the 1985-1988 period, the expansion was led primarily by residential construction and business investment in plant and equipment. The strength of the expansion was based on a number of developments. These included growth in personal income and corporate profits, healthy growth abroad, lower oil prices, stable interest and inflation rates and an exchange rate that enhanced international competitiveness.

Real business investment grew at an average annual rate of 14.2 per cent over the 1985-1988 period, reflecting plant expansion to satisfy increased foreign and domestic demand and plant modernization to meet international competition.

An estimated 300,000 homes were built in Ontario over the four-year period 1985 to 1988. Sales of these homes were supported by pent-up demand from the early 1980s, high levels of net interprovincial and international migration, and a decline in mortgage interest rates.

**SOURCES OF REAL GROWTH IN ONTARIO**
**1985-1988**




Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

The Ontario economy has continued to expand in 1988. By the end of this year, the economy will have created a record 180,000 additional jobs. The average unemployment rate in 1988 is estimated at 5.0 per cent, down more than a full percentage point from 1987.

In recent years, growth in Ontario has outpaced that in the rest of Canada; in 1988, however, growth in the country has become more balanced.

- In 1986 and 1987, Ontario's real output expanded at an average annual rate of 5.4 per cent, compared to 2.4 per cent for the rest of Canada.
- In 1988, real output growth in Ontario will be an estimated 4.5 per cent, compared to 4.1 per cent for the rest of the country.

## Key Assumptions: 1989

International and interprovincial exports account for almost half of the provincial GDP. The Ontario economy is therefore highly sensitive to growth in its major export markets. Energy prices and financial markets also have an important bearing on the outlook.

**Ontario's Export Markets, 1987** — **Table 1**

| | Share of Ontario GDP | |
|---|---|---|
| United States | 28.4 | |
| EEC | 1.4 | |
| Japan | 0.4 | |
| Other | 1.9 | |
| Total International | | 32.1 |
| Rest of Canada | | 15.4 |
| Total | | 47.5 |

Source: Ontario Ministry of Treasury and Economics.

*The International Outlook*

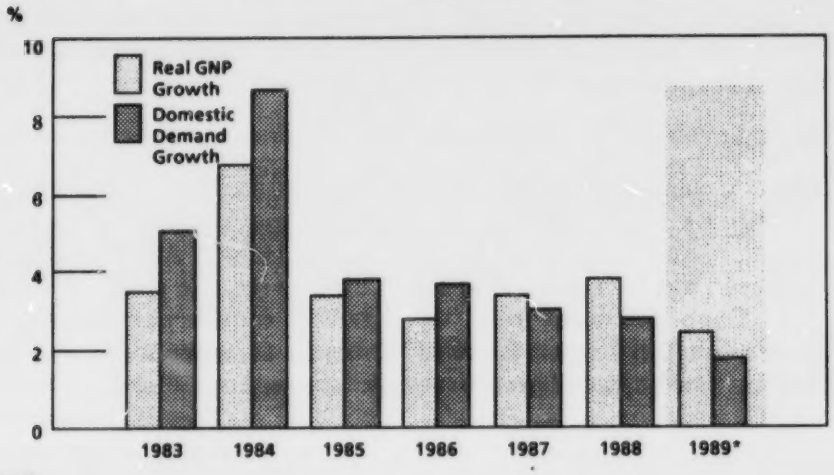
According to International Monetary Fund projections, real output in the Group of Seven industrialized nations will expand by over 4.0 per cent in 1988, surpassing last year's growth rate of 3.2 per cent.

In the U.S., real GNP will post its strongest performance since 1984, based on buoyant exports and machinery and equipment spending. Strong growth in 1988 has reduced unemployment to its lowest level in fourteen years and strained plant capacity. Capacity utilization has risen to 84 per cent -- the highest level since the late 1970s. Higher import prices and the drought have also contributed to cost pressures.

Inflation fears have prompted the Federal Reserve Board to raise interest rates by one and a half percentage points since the spring. The restrictive stance in monetary policy is expected to continue and to restrain inflationary pressures by slowing down economic expansion next year. Weak oil prices should also restrain inflation.

In 1989, the rate of growth of U.S. real GNP will decline to a projected 2.4 per cent from 3.9 per cent in 1988. Consumer price inflation will creep upwards from about 4.0 per cent in 1988 to just under 5.0 per cent in 1989.

**U.S. ECONOMIC PERFORMANCE AND PROSPECTS**
**1983-1989**




* Forecast.

Source: U.S. Department of Commerce and Ontario Ministry of Treasury and Economics.

Despite the relatively strong growth of the past year, considerable uncertainty characterizes the short-term U.S. outlook. The trade deficit remains unsustainably high. It is estimated to be $140 billion (U.S.) in 1988, down from $170 billion in 1987. Nonetheless, this continued high level, coupled with increased outflows of interest payments, raises the prospect of further depreciation of the dollar. The federal budget deficit represents another difficult challenge for the new President; negotiations with Congress will be crucial in setting the direction of fiscal policy. The Administration will have to deal effectively with these twin challenges in order to maintain confidence in the dollar and stability in interest rates.

The outlook for other major industrialized countries is also one of moderating economic growth in 1989. The International Monetary Fund projects that real GDP in the four largest economies of Western Europe will expand by 2.3 per cent on average, after this year's 3.2 per cent advance. Japan's economy is expected to grow by 4.2 per cent, based on strong domestic demand, following a 5.8 per cent rise this year.

*Rest of Canada*

Growth in the rest of Canada in 1989 is expected to make a modest contribution to Ontario's export position, with strength in Quebec and the Atlantic provinces offsetting weakness in Western Canada.

Continuing strength in markets for seafood products and the start of construction on several major projects should enable the Atlantic provinces to grow faster than the national average.

In Quebec, which accounts for the largest proportion of Ontario's interprovincial exports, non-residential construction activity, led by Hydro Quebec's James Bay II power project, will sustain growth in 1989.

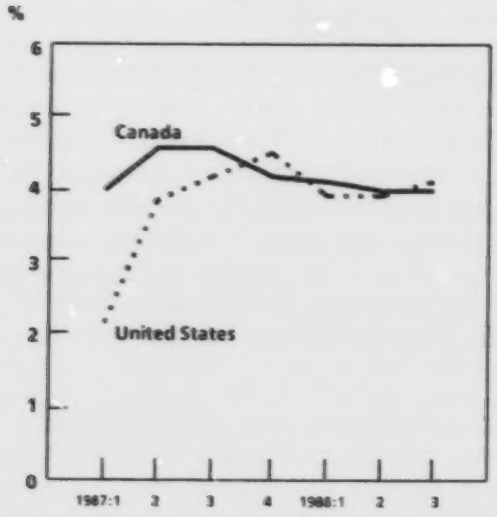
Manitoba and Saskatchewan are expected to record higher growth rates in 1989 as farm output rebounds, following the 1988 drought.

Uncertainty about oil prices is expected to dampen the pace of economic activity in Alberta. Weakness in the U.S. housing market will constrain growth in British Columbia's lumber industry.

*Financial Markets*

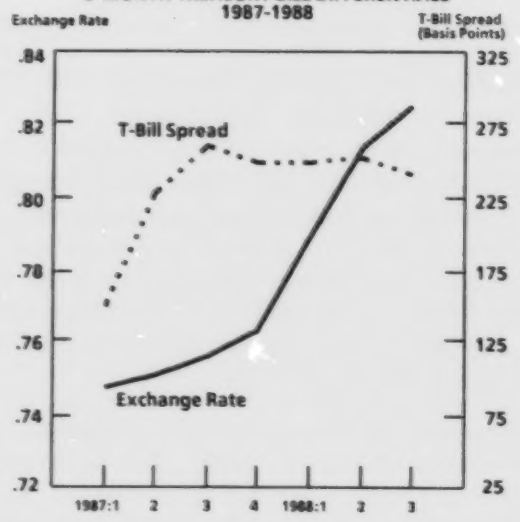
Over the past two years, inflation rates in Canada and the United States have converged. The Bank of Canada has, nevertheless, maintained a wide differential between Canadian and U.S. short-term interest rates. As a result, the real interest rate spread has increased sharply. This has led to a rapid appreciation in the value of the Canadian dollar relative to its U.S. counterpart. In addition, the apparent determination of the Bank of Canada to pursue its anti-inflation objective has reinforced upward pressure on the Canadian dollar.

CANADA AND U.S. CPI INFLATION
1987-1988




Source: Statistics Canada and U.S. Department of Labor.

CANADA-U.S. EXCHANGE RATE AND CANADA-U.S. 3-MONTH TREASURY BILL DIFFERENTIALS
1987-1988




Source: Bank of Canada.

Interest rates in both Canada and the United States are expected to rise by one-half to one percentage point during the first half of 1989. However, as the pace of economic activity slows later in the year, rates are expected to begin to decline.

The recent convergence of Canada-U.S. inflation rates and the rise in the Canadian dollar indicate clearly that there is room for a narrowing of the Canada-U.S. short-term interest rate differential. The forecast assumes that the Bank of Canada will allow the interest differential to narrow somewhat in 1989. The average value of the dollar is expected to remain in the 80 to 83 cent (U.S.) range. (See pages 26-28 for a discussion of the adverse competitive impacts of exchange appreciation.)

*Energy Prices*

For 1988, the province's import bill for oil and natural gas will be an estimated $5.8 billion, 13 per cent lower than in 1987. This drop is principally the result of a modest reduction in international oil prices and an increase in the value of the Canadian dollar.

The outlook for oil prices depends to a considerable degree on developments within OPEC and in the Middle East. In recent months, a number of OPEC members have exceeded their production quotas and oil prices have fallen. Although the prospect of even lower oil prices and lower oil revenues should act as a unifying force within OPEC in 1989, fundamental disagreements within the cartel could lead to continued price weakness.

On the demand side, while the major industrial economies will continue to grow, the associated growth in crude oil demand will be modest and will not have a major influence on crude prices.

On balance, delivered oil prices are expected to fall within the U.S. $15-$17 per barrel range in 1989, down from about U.S. $18.31 in 1987 and U.S. $16.00 in 1988.

## Sources of Growth in 1989: Investment Leads the Way

Business investment will be the strongest source of economic growth in 1989. Growth in other components of domestic demand will moderate, most notably consumer spending and housing.

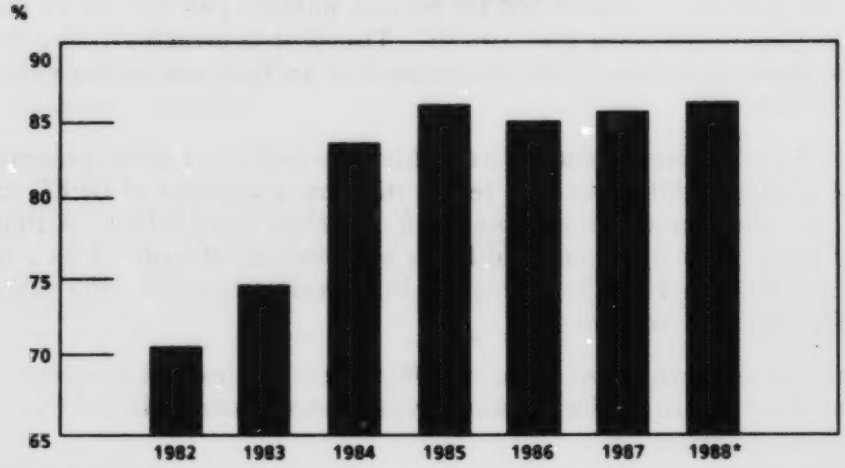
*Business Investment*

Investment in plant and equipment continued to be strong in 1988. Further increases are expected next year, although at a slower pace. Strength in business investment is the result of healthy corporate profits, high rates of capacity utilization, continued sales growth and the introduction of new technologies.

Corporate profits in Ontario are expected to grow by 9.6 per cent in 1989, following an estimated 17.0 per cent rise in 1988. Robust growth in the Canadian economy, strengthening commodity prices and continued cost-cutting measures have all contributed to strong profit growth.

As a result of steady increases in industrial production, capacity utilization rates have risen sharply since the recession of 1981-82. Further increases in sales will spur more investment as businesses move to eliminate production bottlenecks.

**CAPACITY UTILIZATION RATES IN CANADIAN MANUFACTURING**
**1982 - 1988**




* First two quarters.
Source: Bank of Canada.

- The overall capacity utilization rate for total non-farm goods-producing industries in Canada climbed from a low of 69.3 per cent in the last quarter of 1982 to 86.5 per cent in the second quarter of this year.

- Manufacturing industries experiencing capacity utilization rates in excess of 90 per cent include food and beverages, rubber and plastic products, textiles, furniture, primary metals, fabricated metals, electrical and electronic products and non-metallic mineral products. The mining, utilities and energy industries also have capacity utilization rates above 90 per cent.

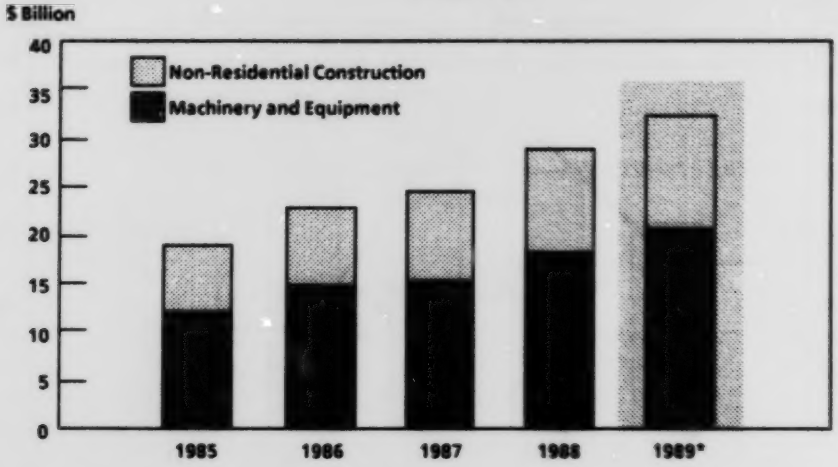
The rise of the Canadian dollar since late 1986 has sharply reduced the cost advantage enjoyed by Ontario industry vis-à-vis U.S. producers. Nevertheless, Ontario remains competitive with other provinces and U.S. states as a production location for most industries. (The issue of competitiveness is discussed more fully in Chapter III.)

Total business investment is forecast to increase from $29.0 billion in 1988 to $32.7 billion in 1989.

- Non-residential construction is expected to grow 10.6 per cent in 1989, after a 15.9 per cent increase this year.

- Machinery and equipment investment is forecast to increase 13.7 per cent in 1989, after an estimated 18.0 per cent increase in 1988.

**BUSINESS INVESTMENT**
**1985-1989**




* Forecast

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

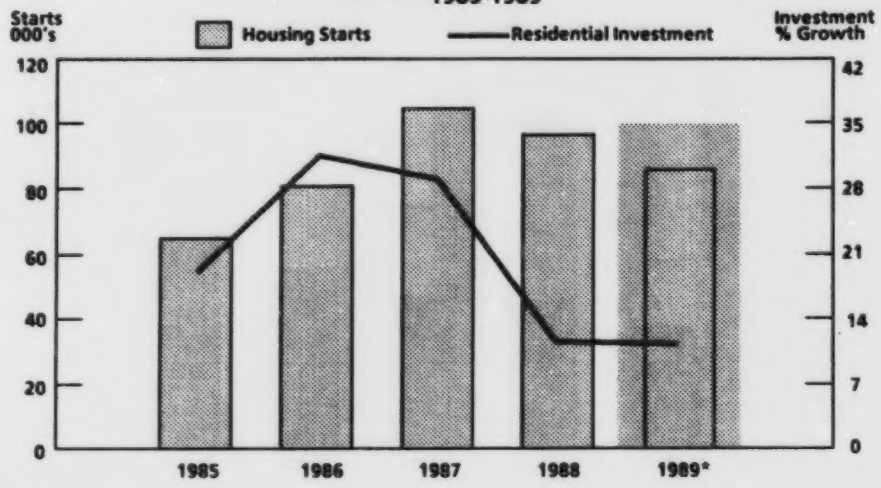
*Housing*

During the early part of the recovery period, household formation outpaced new home construction, causing vacancy rates to fall well below normal levels of about 3 per cent. Since 1985, strong income and employment growth, lower interest rates, pent-up demand from the recession and high levels of immigration have combined to produce strong demand for housing.

Ontario has experienced three years of strong residential investment spending, primarily due to robust activity in new home construction. Over the 1985-87 period, the annual rate of growth for residential investment averaged 26.4 per cent. During the same period, there were more than 250,000 housing starts, an annualized increase which is well above that of the past decade. In 1987 alone, there were 105,213 starts, the highest level since 1973.

New home construction has continued at a healthy pace during 1988, rebounding quickly from a series of strikes during the summer. Housing starts are estimated to total 98,000 in 1988, the second highest level since 1973.

**ONTARIO HOUSING STARTS AND RESIDENTIAL INVESTMENT**
**1985-1989**




* Forecast

Source: CMHC, Statistics Canada and Ontario Ministry of Treasury and Economics.

In 1989, a more sustainable pace of 86,000 starts is expected.

- While the pace of housing starts rose steadily between 1984 and 1987, only since 1987 has new home construction been greater than household formation. With vacancy rates still well below normal levels, new home construction is expected to continue to outpace household formation in 1989.
- Nevertheless, housing activity will be restrained by rising house prices and interest rates.

As housing activity moderates from the extraordinary pace of 1987, the rise in residential investment is expected to slow to 10.1 per cent this year and 9.5 per cent in 1989. Renovation, which currently accounts for about a third of total residential investment, is expected to grow strongly as homeowners continue to improve their property.

*Consumer Spending*

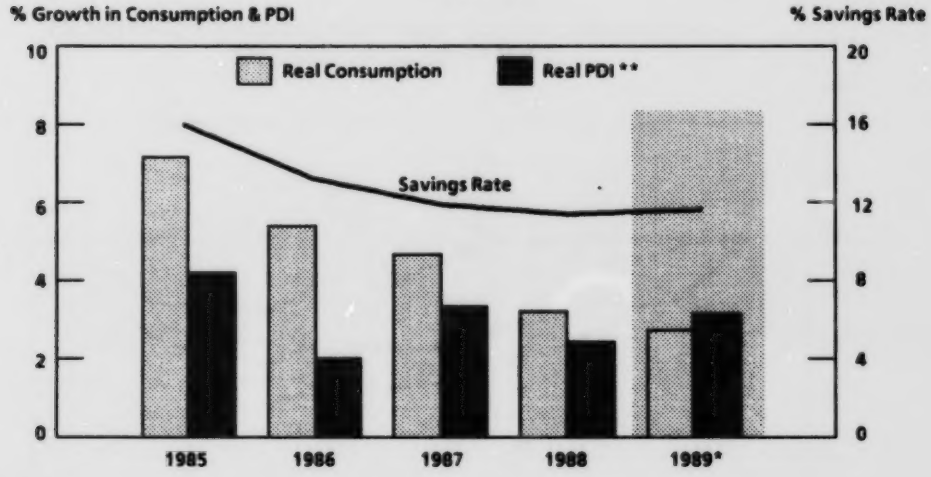
Robust growth in personal income and a decline in the savings rate to a 15-year low fuelled strong consumer spending in 1987. Consumption played a less prominent role in economic growth in 1988. A levelling off in the personal savings rate and slower employment growth will lead to a further reduction in the growth in personal expenditures in 1989.

- Growth in real consumption is forecast at 2.7 per cent in 1989, down from 3.3 per cent in 1988 and 4.7 per cent in 1987.

Spending on services will grow faster than spending on goods. In particular, demand for consumer durables is expected to grow more slowly in 1989. Much of the recent strength in durables reflected the furnishing of newly constructed homes; as the housing boom continues to moderate, this source of demand growth will shrink.

Over the last several years, consumer spending increases have outpaced income growth, driving down the personal savings rate. The savings rate is expected to level off in 1989 as consumers adopt a more cautious spending stance and as savings rates reach those which are contractually fixed (for example, in employer-sponsored pension plans). The rise in interest rates since mid-1988 will also encourage higher personal savings in 1989.

**GROWTH IN REAL CONSUMPTION AND SAVINGS RATE**
**1985-1989**




* **Forecast**

** **Personal Disposable Income**

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Increases in average real wages will partially offset the negative effect of slower employment growth on total personal income. Overall, personal income growth is expected to slow marginally from 8.0 per cent in 1988 to 7.3 per cent in 1989. Recent tax changes have supported growth in disposable income this year, and will continue to do so in 1989.

The burden of household debt payments has grown rapidly since 1985 and will constrain consumer spending in 1989. Between the first quarter of 1985 and the second quarter of 1988, consumer debt by Canadians increased 54.6 per cent while disposable income rose only 19.9 per cent. Interest payments on mortgage debt reached an estimated 25 per cent of household disposable income, up from 18 per cent in 1985. The growth in household debt has also made consumer behaviour more sensitive to interest rate movements and will contribute to slowing consumer spending growth.

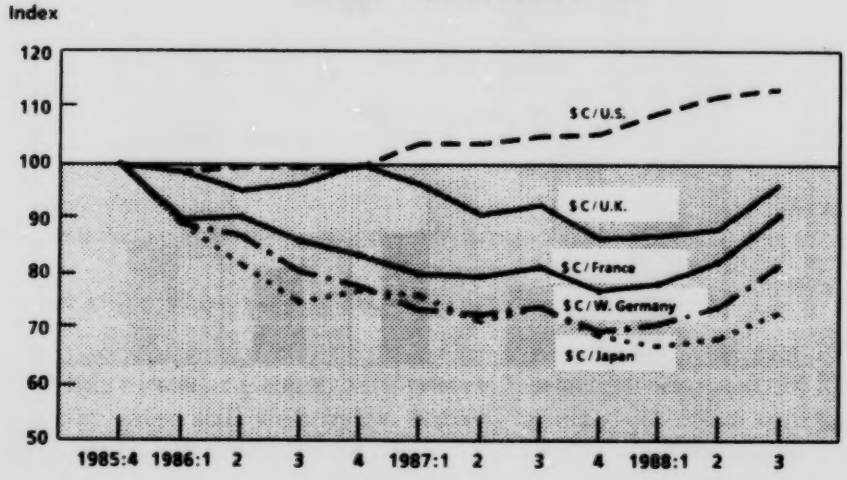
*External Trade*

Exports have increased sharply in 1988. Ontario's auto producers have gained a larger share of the North American auto market, and strong international demand for industrial inputs has spurred exports of resource products, particularly newsprint, chemicals and metals. In nominal terms, Ontario exports are estimated to have grown by more than 9 per cent in 1988, up sharply from 1.1 per cent the previous year.

Over the first nine months of 1988, total Canadian merchandise exports to the U.S. increased 6.8 per cent. Merchandise exports to other countries rose by 22.6 per cent over the same period. This rapid growth in exports to countries other than the U.S. largely reflects the impact of currency realignments over the past three years.

- Between September 1985 and October 1988, the Canadian dollar depreciated 38.1 per cent against the yen, 27.2 per cent against the mark, 18.5 per cent against the franc, and 10.8 per cent against the pound.

**CANADIAN DOLLAR EXCHANGE RATES OF MAJOR CURRENCIES**
**FOURTH QUARTER 1985 = 100**




Source: Bank of Canada.

Overall, Ontario's nominal trade balance is estimated to have improved in 1988 thanks to the rebound in auto exports and much improved terms of trade. In real terms, however, imports of goods and services are growing considerably faster than exports. External trade is therefore having a negative impact on the rate of real growth.

A small decline in the nominal trade surplus is expected in 1989. In real terms, trade will continue to restrain growth.

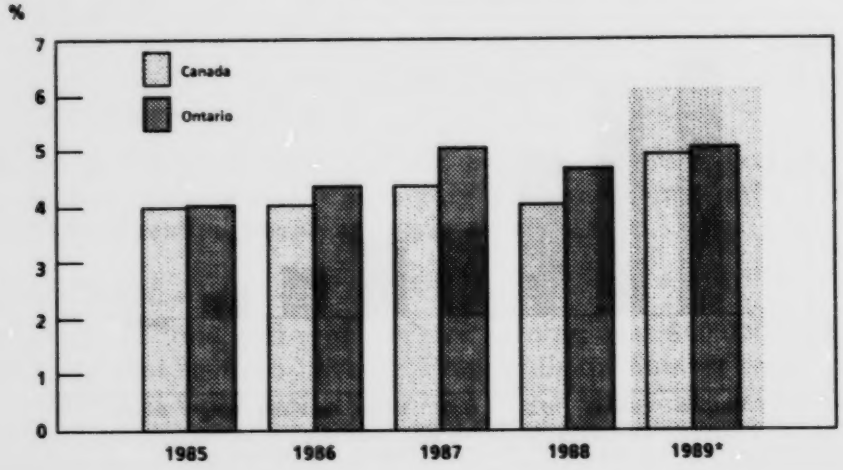
Exports to the United States are expected to rise next year, although the increase will be limited by weaker growth in the U.S. economy. The ongoing effect of recent currency changes, coupled with the relatively strong growth expected in Japan, should lead to a continuing rise in the share of exports destined for third countries in 1989. Within Canada, weakness in Ontario's exports to Western Canada should be offset by stronger exports to Quebec and the Atlantic provinces. Strong investment spending growth in Ontario will lead to a further increase in imports of machinery and equipment.

- **Exports will increase by $3.6 billion to $120 billion in 1989.**
- **Imports are forecast to reach $108 billion in 1989, up $5 billion or 4.9 per cent, from the level in 1988.**

## Inflation

Inflation has been remarkably stable over the past four years, despite increasing tightness in labour markets. Over the 1985 to 1988 period, Ontario's inflation rate, as measured by the Consumer Price Index, ranged from a low of 4.1 per cent to a high of 5.1 per cent.

CANADA AND ONTARIO CPI INFLATION
1985-1989




* Forecast
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

For 1988, Ontario's inflation rate is estimated at 4.7 per cent, down from 5.1 per cent in 1987. Nationally, consumer prices increased approximately 4.1 per cent in 1988, compared to 4.4 per cent in 1987. The 1988 easing of inflation reflects smaller increases in food prices and lower costs for petroleum products.

In 1989, inflation is expected to rise to 5.1 per cent in Ontario and to 4.9 per cent nationally. Several factors will contribute to the rise in inflation.

- The 1988 drought is expected to add to price pressures next year.
- The recent run-up in many non-agricultural raw material prices will be passed through into consumer prices.
- Wage increases exceeded the inflation rate in 1988. The resulting real wage gains may increase upward price pressures, particularly for services.

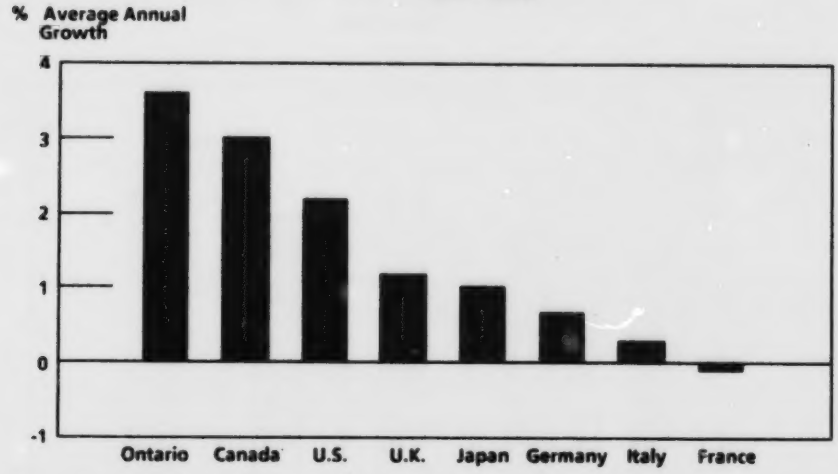
Partially offsetting these factors will be the ongoing impact of Canadian dollar appreciation, less rapid economic growth and an expected slowing in house price increases. Oil prices may also contribute to moderating inflationary pressure in 1989, although to a smaller degree than in 1988.

The gap between the Ontario and national inflation rates in recent years has been primarily the result of greater house price increases in the Toronto region. In 1989, the Ontario-Canada gap is expected to narrow as house price increases in southern Ontario moderate.

## Employment and the Labour Force

**Over the four-year period 1985 to 1988, the number of employed Ontarians increased by 643,000 -- an average annual growth rate of 3.6 per cent, higher than in any major industrial country.**

INTERNATIONAL COMPARISON OF EMPLOYMENT GROWTH
1985-1988




Source: O.E.C.D., Statistics Canada and Ontario Ministry of Treasury and Economics.

In 1989, employment is forecast to grow by 105,000. The unemployment rate will average 5.0 per cent next year, unchanged from 1988.

**Ontario Labour Market Outlook** — **Table 2**

| | 1987 | 1988 | 1989 |
|---|---|---|---|
| Labour Force (000s) | 5,013 | 5,145 | 5,253 |
| Change (%) | 2.4 | 2.6 | 2.1 |
| Employment (000s) | 4,706 | 4,886 | 4,991 |
| Change (%) | 3.3 | 3.8 | 2.1 |
| Job Creation (000s) | 151 | 180 | 105 |
| Unemployment (000s) | 307 | 259 | 262 |
| Unemployment Rate (%) | 6.1 | 5.0 | 5.0 |
| Participation Rate (%) | 68.9 | 69.4 | 69.7 |

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

### Job Growth

*Jobs Across Industries*

**In recent years, the industrial composition of employment in Ontario has largely continued along long-term trends. In 1988, the service sector accounted for 68.2 per cent of the employed workforce, compared to 66.6 per cent in 1985.**

- During the 1985 to 1988 period, the community, business and personal services industry contributed the largest number of new jobs, but the highest percentage growth in employment occurred in the communications industry.
- Within the goods-producing sector, employment growth was fastest in construction, reflecting the boom in the commercial and residential property markets. Manufacturing employment grew by over four per cent.
- Employment in the primary sector grew by almost two per cent. While the mining industry posted a healthy 29 per cent increase, reflecting strong commodity prices, employment in agriculture and forestry fell.

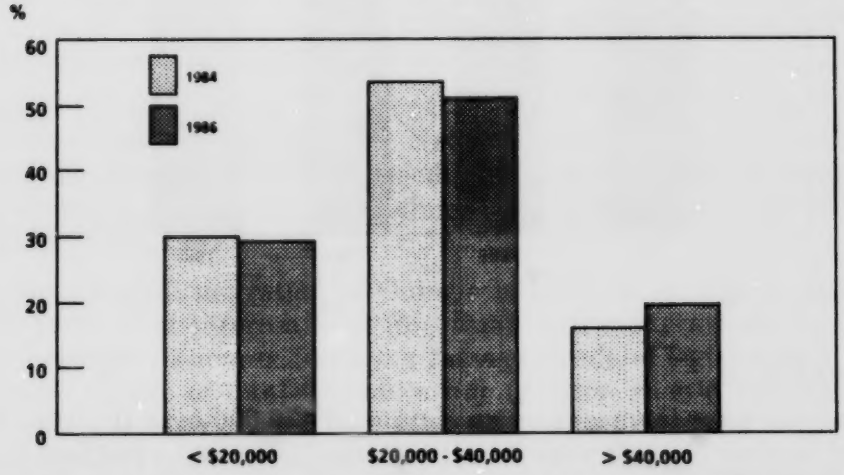
The private sector's share of Ontario employment remained unchanged at about 80 per cent over the 1985 to 1988 period. Self-employment accounted for 16 per cent of private sector employment.

Employment growth in the public sector, broadly defined to include all public enterprises and institutions which rely primarily on public funds, was concentrated in education, health and social services.

*The Quality of Employment*

The number of full-time, full-year workers earning over $40,000 (1986 dollars) increased 35 per cent between 1984 and 1986, while the number earning less than $40,000 increased slightly over six per cent. As a result, the proportion of full-time, full-year employment accounted for by higher-paid earners increased from 16 per cent in 1984 to 20 per cent in 1986. The share of lower-paid earners fell by four percentage points.

**ONTARIO EMPLOYMENT BY EARNINGS* CATEGORY**
**1984 - 1986**




* In 1986 Dollars. Includes full-time, full-year paid employment by heads of households, spouses and unattached individuals.

Source: Statistics Canada.

Employment in the managerial and professional occupations showed strong growth in 1988 and is expected to continue the trend underway since the expansion began.

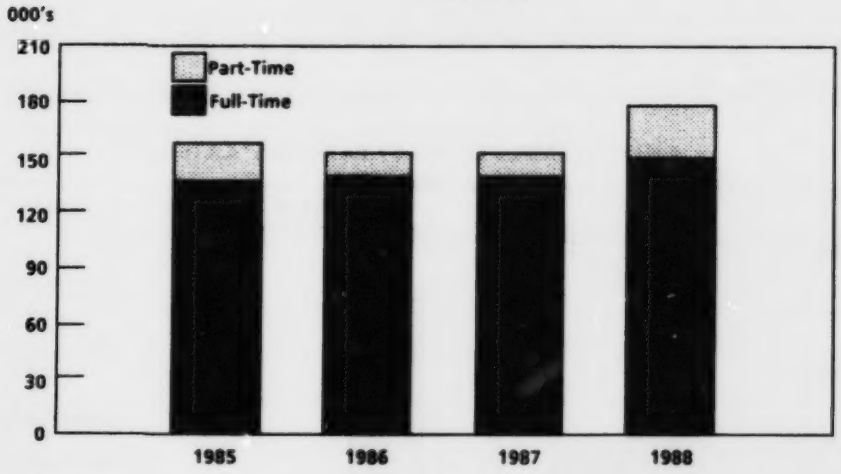
- The number of workers in these occupations increased 25 per cent over the 1985 to 1988 period, compared to 12 per cent for other occupations. These occupations continue to be the highest paid in the labour market.
- Managerial and professional occupations accounted for 30 per cent of all Ontario employment in 1988.

*Full-Time Jobs*

Over the four-year period ending in 1988, full-time employment expanded by 16 per cent, compared to 12 per cent for part-time work.

- Full-time job creation has accounted for 88 per cent of the total new employment in this period.
- The largest addition to part-time employment occurred in the trade and the community, business and personal services sectors which together contributed 70,000 part-time jobs.

**ONTARIO JOB CREATION**
**1985-1988**



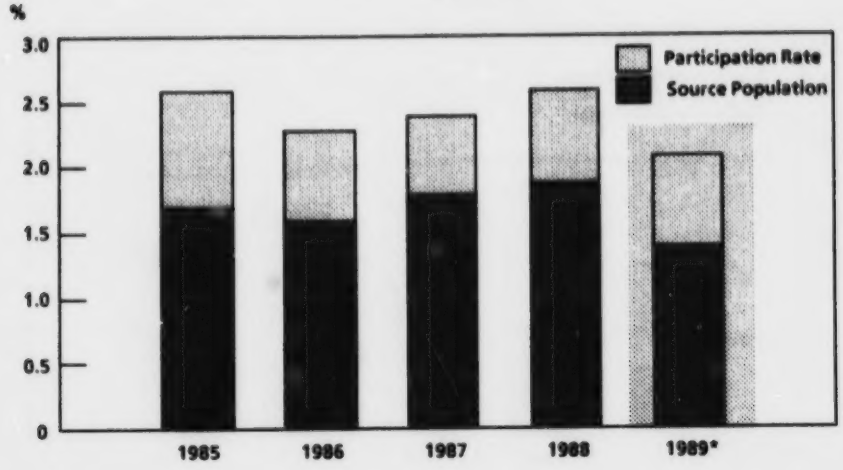

Source: Statistics Canada.

## The Labour Force

Ontario's labour force increased by an estimated 479,000 over the 1985 to 1988 period. The number of adult women in the labour force rose by 295,000 and adult men by 203,000. The number of young workers declined slightly as the smaller cohorts of the post-baby boom generation entered the labour market.

Ontario's labour force is expected to grow by 2.1 per cent in 1989, down from 2.6 per cent in 1988. Source population growth contributed 73 per cent of the 1988 growth in labour supply, with participation rate increases accounting for the remaining 27 per cent.

**ONTARIO LABOUR FORCE GROWTH**
**1985-1989**




* Forecast

Source: Statistics Canada and Ontario Ministry of Treasury and Economics

*Population Growth*

About 50 per cent of international migrants and 55 per cent of interprovincial migrants enter the labour force on arrival in Ontario.

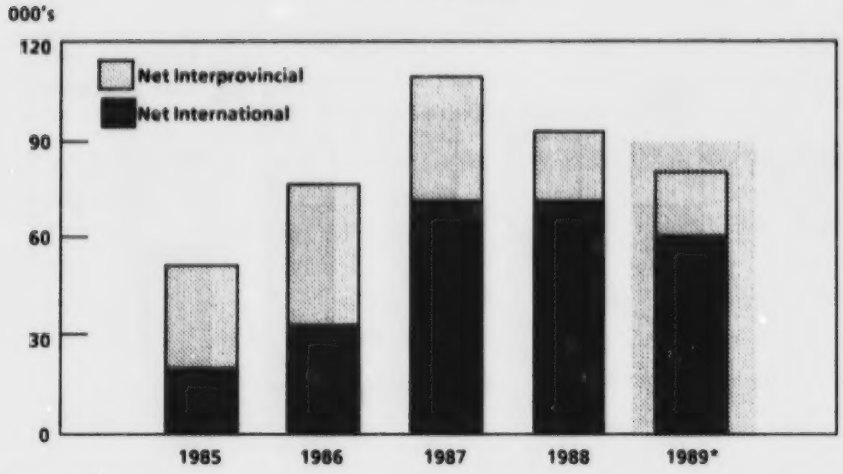
Ontario's population grew from 9.0 million in 1985 to 9.4 million in 1988. Net migration accounted for almost 60 per cent of this growth.

Net migration to Ontario from outside Canada was high over the 1986-1988 period, averaging about 59,000 per year. In 1987, net international migration, including refugee claimants, reached 72,000, the highest level since 1975. The 1988 level is expected to be similar to that in 1987.

Net interprovincial migration has played an important, though smaller, role in Ontario's recent population growth. Net interprovincial migration averaged 35,000 per year over the 1986-1988 period, reflecting the faster economic recovery in Ontario. The net inflow is now slowing and should amount to 22,000 in 1988, down from 38,000 in 1987.

In 1989, net external migration to Ontario is likely to decline to 80,000 from 94,000 in 1988. Net international migration will moderate as a result of a decrease in refugee claimants, following passage of federal legislation in 1988. As well, Ontario's share of total Canadian immigration should decline from the unusually high levels recorded this year. Net interprovincial migration will continue to decline, but not as rapidly as in 1988.

**MIGRATION TO ONTARIO**
**1985-1989**




* **Forecast.**

Source: Statistics Canada, Employment and Immigration Canada and Ontario Ministry of Treasury and Economics.

*Participation Rates*

Strong demand for labour has encouraged persons outside the labour force, primarily women and young people, to enter the job market. The increase in labour force participation over the 1985 to 1988 period has added about 150,000 workers to Ontario's labour supply.

In 1988, Ontario's aggregate labour market participation rate increased to 69.4 per cent, the highest in Ontario's history. By way of comparison, the U.S. aggregate labour force participation rate is 66 per cent. Ontario's rate is higher than that of any of the ten largest industrial states in the United States.

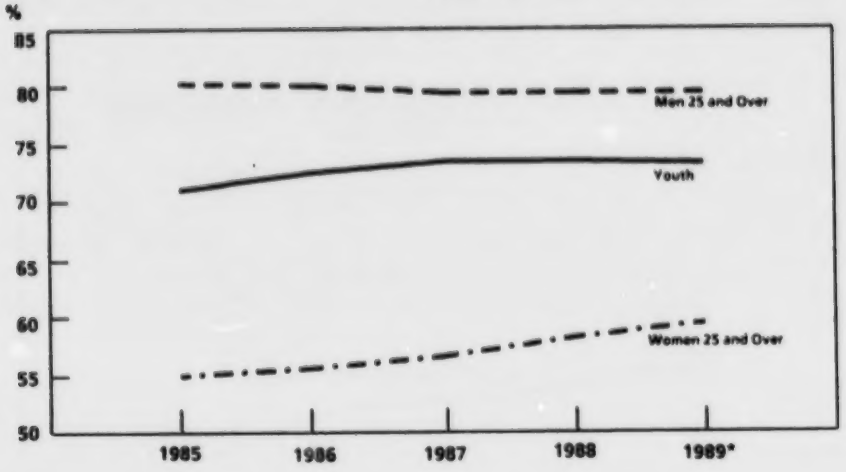
The participation rate of adult men was more than 79 per cent in 1988, about the same as the 1987 level. Over the long-term, the male participation rate has been declining.

The participation rate of women aged 25 and over has increased by more than four percentage points over the past four years, reaching 58 per cent in 1988. The gap between adult male and adult female rates will narrow to about 20 percentage points in 1989. The female share of the labour force is expected to rise to slightly over 45 per cent in 1989.

The youth participation rate was over 73 per cent in 1988, an increase of almost three percentage points since 1985. This reflects higher part-time labour force participation among young people; full-time labour force participation by youth declined over the period. This is consistent with increasing educational enrollment; the full-time school enrollment rate for young people rose by about five percentage points over the 1985 to 1988 period.

Prime-age workers (25-44) will constitute 53 per cent of the labour force in 1989, up from 50 per cent in 1985.

**ONTARIO PARTICIPATION RATES**
**1985-1989**




* Forecast

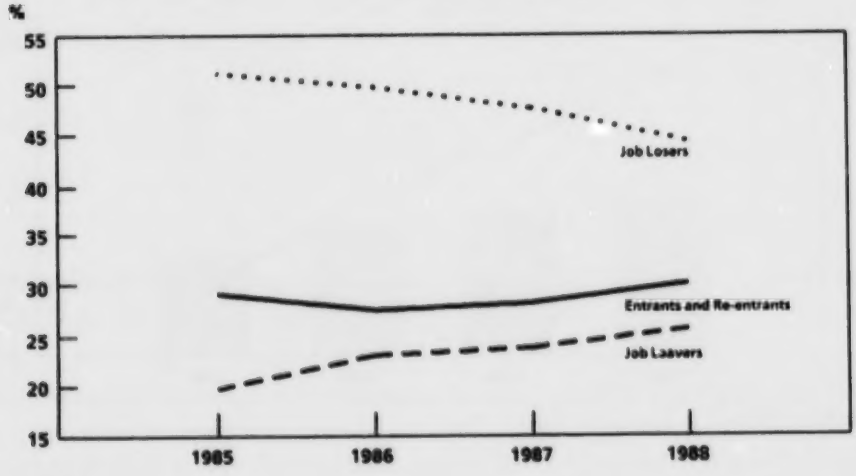
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

## Changing Patterns of Unemployment

The continuing economic expansion has not only reduced unemployment in Ontario; it has also changed its nature.

Layoffs have become less important as a cause of unemployment. The job losers' share of total unemployment fell from 51 per cent to 44 per cent during the 1985-1988 period, while the share of entrants and re-entrants edged upward. The proportion of unemployment accounted for by job leavers rose from 20 per cent in 1985 to 26 per cent in 1988.

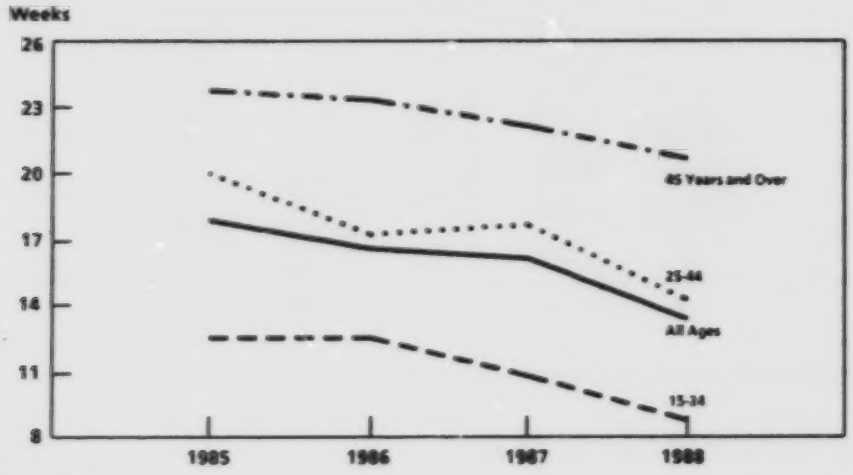
**COMPONENTS OF ONTARIO UNEMPLOYMENT**
**1985-1988**




Source: Statistics Canada.

The average duration of unemployment returned to pre-recession levels for the first time in 1988. On average, unemployed persons were without work for 13 weeks in 1988. Only for older workers (aged 45 and over) was the average duration of joblessness longer in 1988 than in 1981.

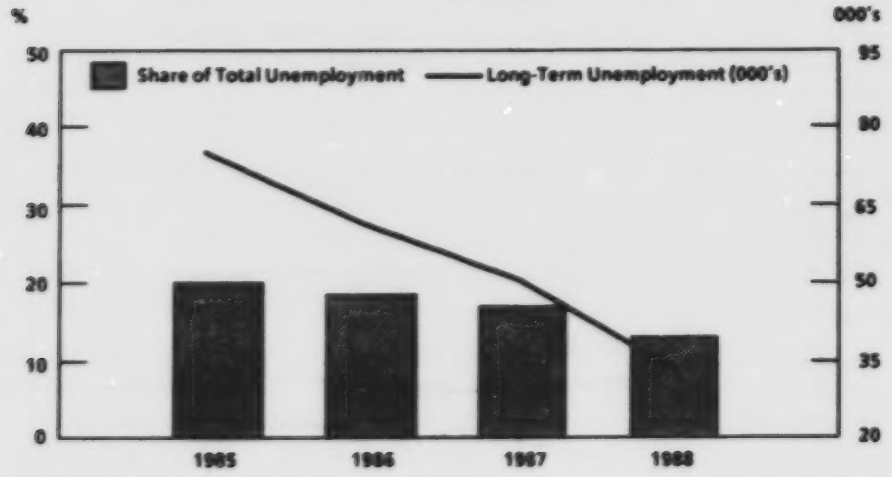
**ONTARIO AVERAGE DURATION OF UNEMPLOYMENT**
**1985-1988**




Source: Statistics Canada.

Long-term unemployment, defined as unemployment of six months or more, has also declined substantially. In 1988, long-duration unemployment declined in all parts of Ontario, with the largest decline in Northern Ontario.

**ONTARIO LONG-TERM UNEMPLOYMENT**
**1985-1988**



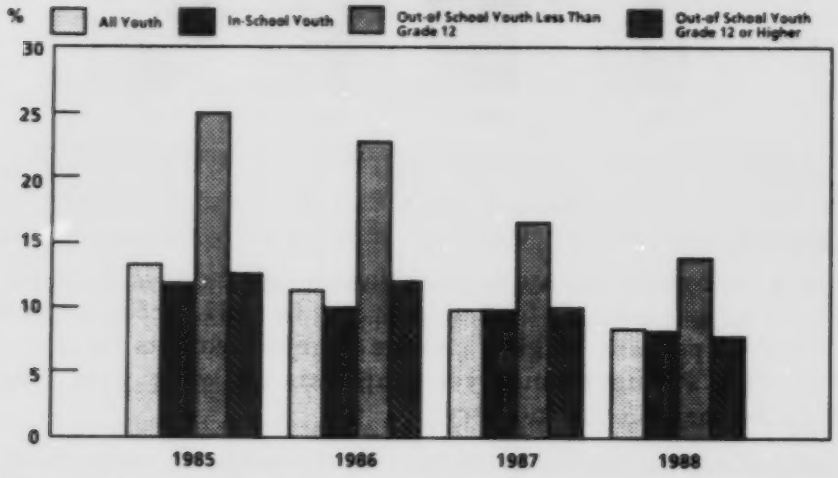

Source: Statistics Canada.

The number of workers unemployed for more than six months averaged 33,000 in 1988, down from 51,000 in 1987. This compares to a pre-recession level of 41,000 in 1981.

The least educated are over-represented in long-term unemployment. In 1988, those with no post-secondary education accounted for 58 per cent of the labour force, but 67 per cent of long-term unemployment.

The youth unemployment rate fell from 13.2 per cent in 1985 to 8.5 per cent in 1988. The decline was most significant for school dropouts, whose unemployment rate fell from 25 per cent in 1985 to about 16 per cent in 1988. The number of unemployed dropouts, defined as out-of-school youth with less than grade 12 education, fell from 46,000 to 22,000 over the period.

**ONTARIO YOUTH UNEMPLOYMENT RATES**
**1985-1988**




Source: Statistics Canada.

Strong job growth in 1988 has reduced unemployment rates in all major urban areas of the province. Labour markets were particularly tight in Toronto, London, Oshawa and Kitchener-Waterloo, all of which had unemployment rates of less than five per cent in 1988.

## Compensation

### *Earnings*

Ontario weekly earnings per worker have shown modest real growth since late 1987, reflecting strong economic performance and increasingly tight labour markets.

- Average weekly earnings increased by 6.2 per cent in the first eight months of 1988, compared to the same period in 1987. This represented real growth of 1.7 percentage points above the Ontario consumer price rise of 4.5 per cent.

Weekly earnings increases were most pronounced in the service sector, particularly the finance, insurance and real estate, and the community, business and personal services industries. The higher service sector earnings growth in

1988 represents a reversal of the previous year's experience when earnings growth in this sector lagged behind growth in the goods-producing sector.

* January to August 1988.

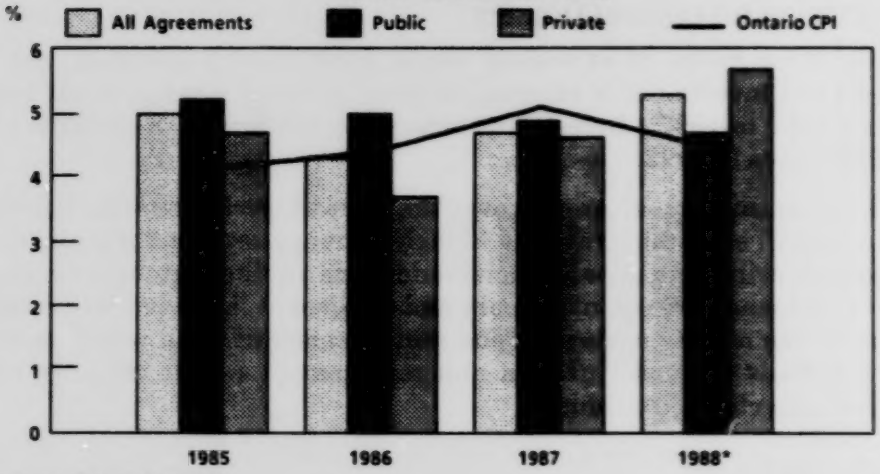
Source: Statistics Canada.

*Wage Settlements*

Collective bargaining settlements in Ontario through the first three quarters of 1988 averaged 5.3 per cent, up from 4.7 per cent in 1987. Inflation in the same period averaged 4.5 per cent. Higher average wage settlements reflect continuing economic growth, stronger employee emphasis on wage gains, and high settlements in the construction industry.

- Private sector settlements exceeded those in the public sector in the first three quarters of 1988, averaging 5.7 per cent, compared to 4.7 per cent for the public sector.
- Construction settlements averaged 6.2 per cent and accounted for about 40 per cent of all employees covered by collective agreements negotiated in the first three quarters of 1988.

**ONTARIO WAGE SETTLEMENTS, 1985-1988**
**(OVER 500 EMPLOYEES)**




* January to September 1988.
Source: Labour Canada and Statistics Canada.

Ontario wage increases continue to exceed those at the national level.

- In the first three quarters of 1988, Canadian settlements for the private and public sectors averaged 4.2 per cent, up slightly from 4.1 per cent in 1987.

In 1989, Ontario settlements will continue to lead those in the rest of the country. Wage increases are also likely to remain somewhat above inflation.

*Non-wage Compensation*

Major non-wage compensation items include mandatory employer payments for the Canada Pension Plan (CPP), Unemployment Insurance (UI), and Workers' Compensation (WCB), as well as non-mandatory payments for Ontario Health Insurance (OHIP), and private health and pension plans. Over the 1985 to 1988 period, non-wage compensation has constituted a stable 9.2 per cent of labour income.

Over the same period, mandatory employer payments for UI, CPP, and WCB have grown faster than non-mandatory items; in 1987, they accounted for about half of total non-wage payments. The main increases occurred in WCB and UI premiums. The pace of WCB premium growth is expected to slow due to the recent legislative reforms in workers' compensation and occupational health and safety. UI contribution rates will decrease in 1989 as a result of a projected UI fund surplus. CPP premiums will continue to increase in 1989 and future years as a result of the federal government's amendments to the CPP Act.

## Ontario Manufacturing Investment

### Manufacturing Investment Outlook

Following three years of extremely rapid growth (15.1 per cent per year), manufacturing investment is expected to grow by about 4 per cent per year over the period 1989 to 1992. Investment outlays by Ontario manufacturers should exceed $10 billion in 1992.

The slowing in investment growth over the forecast period reflects the expected easing in overall economic growth, a higher exchange rate, and the completion of major restructuring and new capacity additions in the automotive and steel industries. Expenditures on machinery and equipment, however, will continue to be driven by the need to modernize and remain competitive in world markets. A greater emphasis on modernization and replacement rather than on capacity additions is expected to continue.

### Recent Performance

Over the past three years, investment in manufacturing has been an important source of growth for Ontario's economy. Firms have undertaken major expenditures, particularly in automobiles and steel, to introduce new technologies and enhance international competitiveness.

Ontario manufacturing investment growth was very strong in the 1986 to 1988 period, with double-digit growth in most manufacturing industries.

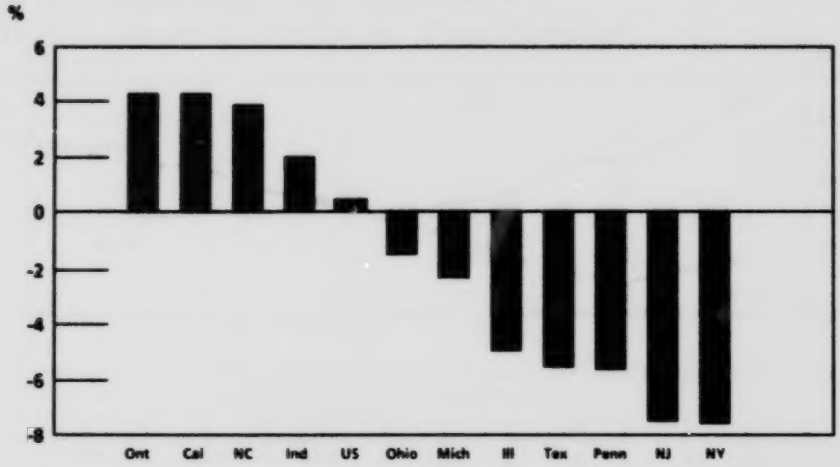
- Manufacturing outlays on plant and equipment in 1988 are expected to be up by 17.4 per cent relative to 1987 levels.

Particularly rapid growth is occurring in the wood, paper and allied and non-metallic minerals industries. Only three industries are anticipating a reduction in 1988 capital expenditures: primary metals, metal fabricating and printing and publishing.

The strength in investment is reflected in job growth. Ontario job creation in manufacturing has outpaced that in the United States.

- Over the 1985 to 1988 period, Ontario manufacturing employment grew by 4. 4 per cent, or 44,000 jobs. Manufacturing employment fell by 2.1 per cent over the same period in the ten largest industrial states in the U.S., reflecting a net loss of 227,000 jobs.

**MANUFACTURING EMPLOYMENT GROWTH**
**1985-1988**




**Note:** **1988 Forecast.**
Source: Statistics Canada , D.R.I. and U.S. Department of Commerce.

**The overall strength of manufacturing investment growth has been driven by rapid sales increases, high capacity utilization rates, strong profit growth and a much improved debt/equity ratio.**

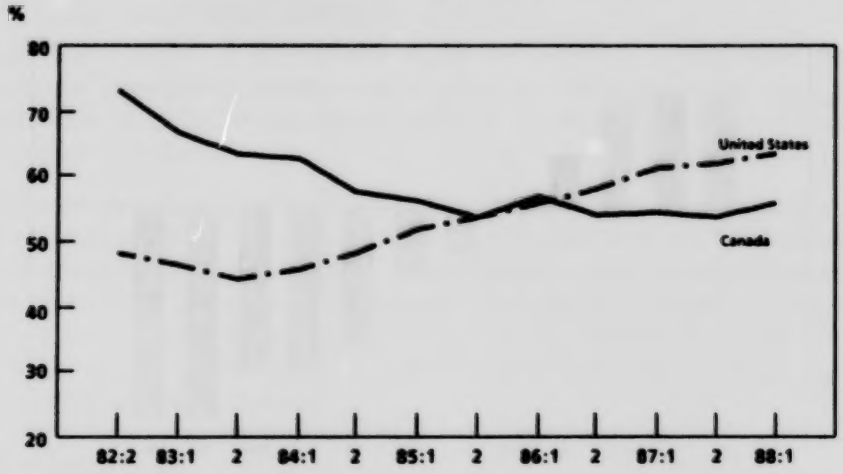
- **Sales Growth: Manufacturing shipment increases averaged 7.5 per cent in the 1984-87 period, with the highest growth for non-metallic minerals, wood, machinery, and transportation equipment.**

- **Capacity Utilization: Capacity utilization stood at 86.3 per cent in the first half of 1988, some 15 percentage points above the 1981-82 recession level. Manufacturing industries that are operating at rates of 95 per cent or higher are rubber and plastic products and non-metallic mineral products. The higher rates of capacity utilization were achieved despite noticeable additions to capacity. In the past three years, total manufacturing capacity has risen by 11 per cent. Increases in excess of 35 per cent have occurred in the transportation equipment and electrical and electronics sectors.**

- **Profitability: Operating profits as a share of sales in the manufacturing sector have increased from two per cent in 1982 to six per cent in 1987. Profitability has returned to levels experienced prior to the recession. Within manufacturing, the strongest profit performance was achieved in paper and forestry, printing and publishing, primary metals, textile and knitting mills and wood industries.**

- **Debt/Equity Ratios: Although still above pre-recession levels, the average ratio of debt to equity in Canadian manufacturing fell from 73 per cent in late 1982 to 56 per cent in the first half of 1988. By contrast, the U.S. debt/equity ratio, which was well below the Canadian level early in the decade, has risen sharply and now exceeds the Canadian level.**

**MANUFACTURING DEBT/EQUITY RATIOS**
**1982-1988**




Source: Statistics Canada and U.S. Department of Commerce.

## Manufacturing Competitiveness

While the factors reviewed above are providing the overall impetus for manufacturing investment growth, manufacturing investment location decisions are based on an additional set of considerations. Factors contributing to Ontario's attractiveness as a location for investment include favourable labour and energy costs, productivity (which is largely dependent on new technology and new products), a growing and increasingly well-educated labour force, and an efficient public infrastructure.

### *Exchange Rates*

In recent years, changes in international currency exchange rates have dwarfed other factors, such as increases in labour compensation or productivity growth rates, as a cause of variations in international competitiveness.

- Since 1985, Japanese and European exchange-adjusted hourly compensation costs have risen dramatically in relation to U.S. and Canadian rates. Japanese rates are becoming comparable; European rates are significantly higher.
- Since 1987, Canadian compensation costs have risen virtually to U.S. levels, primarily as a result of exchange rate changes, while as recently as 1985 they were 17 per cent below U.S. levels.

**Hourly Compensation for Production Workers in Total Manufacturing: 1975-1988 Canada, U.S., South Korea, Japan, West Germany** **Table 3**
(Index U.S. = 100)

| Country | 1975 | 1980 | 1985 | 1987 | 1988* |
|---|---|---|---|---|---|
| United States | 100 | 100 | 100 | 100 | 100 |
| Canada | 91 | 85 | 83 | 89 | 96 |
| South Korea | 6 | 10 | 10 | 13 | 14 |
| Japan | 48 | 57 | 50 | 83 | 93 |
| West Germany | 100 | 125 | 74 | 126 | 129 |

Source: U. S. Department of Labor
Notes: * Applying January - October 1988 average exchange rates to 1987's compensation costs. For other years, data adjusted for each year's exchange rates. Compensation includes wages and benefits.

As the following table indicates, at current exchange rates, Canadian hourly compensation costs in manufacturing remain slightly below U.S. manufacturers in many industries, but are higher in other industries such as paper, wood products and textiles.

**Hourly Compensation for Selected Industries, 1988 Canada, U.S., Japan, Korea, Germany** **Table 4**
(In U.S. Dollars, applying January-October 1988 exchange rate to 1987 compensation costs)

| Industry | Canada | U.S. | Japan | Korea | Germany |
|---|---|---|---|---|---|
| **Total Manufacturing** | **12.85** | **13.44** | **12.48** | **1.99** | **17.30** |
| Transportation Equipment | 15.16 | 18.54 | 15.68 | 2.85 | 21.70 |
| Electrical Products | 12.18 | 13.59 | 11.32 | 1.96 | 16.67 |
| Textiles | 9.80 | 9.11 | 9.14 | 1.65 | 13.29 |
| Lumber and Wood Products | 11.61 | 10.49 | 10.07 | 1.81 | 15.54 |
| Fabricated Metals | 12.63 | 13.56 | 12.27 | 2.09 | 15.92 |
| Machinery | 13.39 | 14.55 | 14.22 | 2.28 | 18.05 |
| Chemicals | 13.79 | 17.03 | 20.08 | 2.79 | 19.61 |
| Paper | 16.86 | 15.76 | 13.37 | 2.15 | 15.99 |
| Food and Related (Processing) | 11.93 | 12.45 | 10.34 | 2.08 | 14.70 |

Source: U. S. Department of Labor.

Ontario hourly earnings (excluding benefits) for the manufacturing sector as a whole also remain in line with most major U.S. industrial states. Production workers in Ontario manufacturing earned an average of $10.75 U.S. per hour (not including benefits) during the first two quarters of 1988. These hourly earnings are comparable to the major industrial states bordering the province, such as New York and Ohio. They are substantially below those in Michigan. However, if the exchange rate were to increase to $0.85 U.S., Ontario's hourly earning levels would be higher than in seven of the ten largest manufacturing states.

**Hourly Manufacturing Earnings, 1988** **Table 5**
(U.S. Dollars)

| | | | |
|---|---|---|---|
| North Carolina | 8.06 | | |
| **Ontario ($Cdn = 75 cents U.S.)** | | **9.83** | **(2nd rank)** |
| Texas | 9.93 | | |
| Pennsylvania | 10.18 | | |
| New York | 10.30 | | |
| **Ontario ($Cdn = 82 cents U.S.)** | | **10.75** | **(5th rank)** |
| California | 10.80 | | |
| New Jersey | 10.81 | | |
| Illinois | 11.07 | | |
| **Ontario ($ Cdn = 85 cents U.S.)** | | **11.14** | **(8th rank)** |
| Indiana | 11.36 | | |
| Ohio | 11.95 | | |
| Michigan | 13.36 | | |

Note: Based on January-June 1988.
Source: Statistics Canada and U.S. Department of Labor.

*International Competitiveness: Electricity Rates*

**Ontario has a substantial advantage over most U.S. states in industrial power costs due to Ontario's low-cost hydro-electric and nuclear power generation.**

- **The average monthly industrial electricity bill in most major industrial states is more than 50 per cent higher than in Ontario.**

**Monthly Industrial Electricity Bill, 1988** **Table 6**
(Canadian Dollars)

| | | |
|---|---|---|
| New York | New York | 45,039 |
| Massachusetts | Boston | 38,857 |
| California | Los Angeles | 34,555 |
| Michigan | Detroit | 34,028 |
| Illinois | Chicago | 34,005 |
| North Carolina | Charlotte | 29,458 |
| Texas | Dallas | 23,328 |
| **Ontario** | **Toronto** | **22,104** |

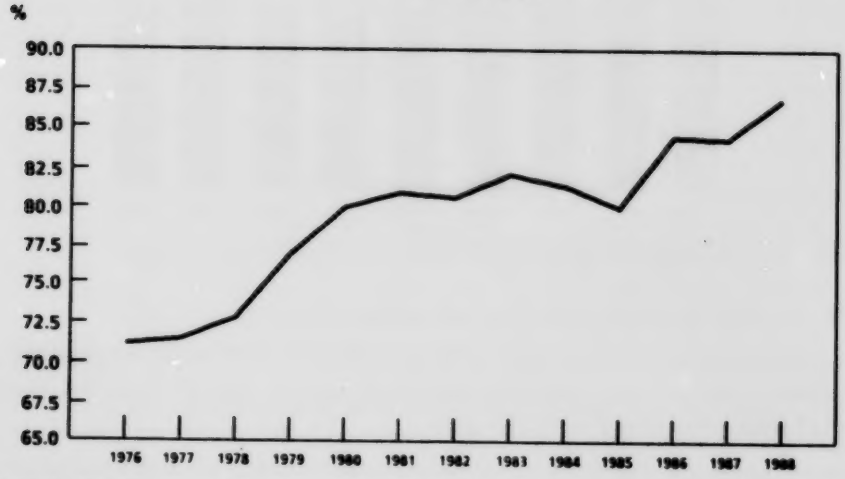
Note: Relevant exchange rate is $1 Cdn = $0.82 U.S.
Based on industrial user with 400,000 kW.h consumption and peak demand of 1,000 kW (July 1988 rates).
Source: Ontario Hydro and the Tennessee Valley Authority.

*New Machinery: Added Productivity*

During the 1985 to 1988 period, manufacturing productivity has grown an estimated 11.8 per cent, faster than that of the service sector. Productivity increases have been particularly high in industries such as pulp and paper. High productivity gains are also anticipated in motor vehicle assembly as recent investments lead to major increases in output.

The underlying reason for this increase in productivity has been investment in new machines embodying more productive technologies that improve product quality, reduce labour costs and increase control over the production process. This is reflected in changes in the composition of investment by Ontario manufacturers.

**MACHINERY AND EQUIPMENT EXPENDITURES AS A % OF TOTAL CAPITAL EXPENDITURE, ONTARIO MANUFACTURING INDUSTRIES 1976-1988**




Source: Statistics Canada.

- In 1976, 71 per cent of capital outlays were for machinery and equipment and the remaining 29 per cent were for buildings.
- By 1988, 87 per cent of capital outlays were for acquisition of machinery and equipment.
- By 1985, an estimated 43 per cent of manufacturing firms in Canada had installed some form of process automation. The most commonly used form of process automation was computer-based manufacturing, followed by computer-aided design and computer numerical control.

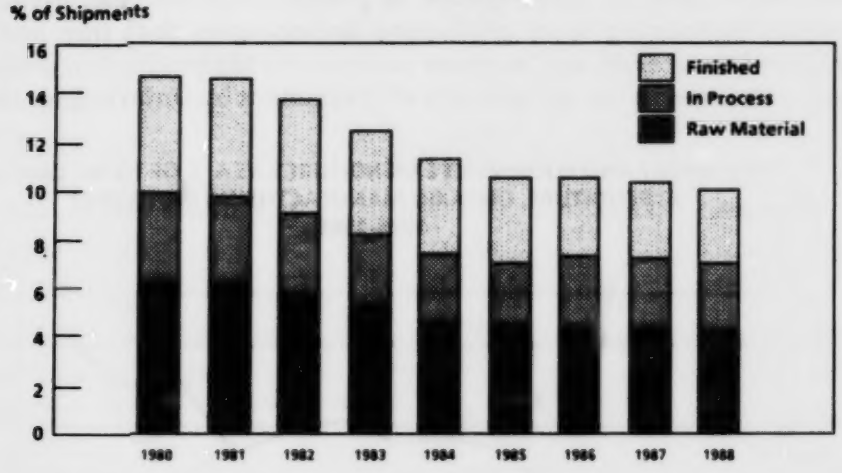
Based on the results of a 1985 survey, manufacturing expenditures on robotics and computer equipment represented 13 per cent of total machinery and equipment investments. Even larger investment levels in robotics and computerized equipment have been realized since 1985, particularly in the automotive sector.

Advances in information technology, much improved process equipment and new relationships with suppliers, such as just-in-time delivery, have led to substantial

reductions in costs. These reductions are, in part, achieved by declining inventory-to-shipment ratios for raw materials, goods-in-process and for finished goods.

- Measured as a percentage of sales, manufacturing inventories fell from 14.8 per cent in 1980 to 10.2 per cent in 1988.

**INVENTORY / SHIPMENT RATIO: ONTARIO MANUFACTURING SECTOR 1980-1988**




Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

*New Products: Research and Development Expenditure*

New high-value added products are also essential to productivity growth. In this regard, research and development expenditures are a measure of the potential for inventions of new products and processes.

While expenditures on R&D by Ontario manufacturers as a proportion of output are still less than half the levels of their counterparts in the U.S., R&D expenditures by Ontario manufacturing have more than tripled between 1979 and 1986.

- In 1986, Ontario's manufacturing accounted for 64.6 per cent of Canadian manufacturing R&D expenditures, compared with 56.1 per cent in 1979.
- Ontario accounts for more than 85 per cent of Canadian R&D in telecommunications, 70 per cent in primary metals, 67 per cent in food processing, and 86 per cent in scientific equipment.

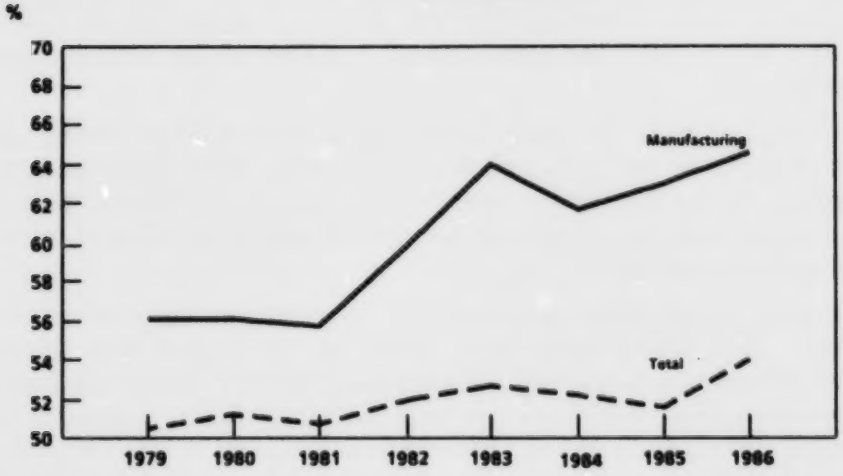
The federal and provincial governments support R&D performed by business through tax expenditures and other forms of assistance.

- A corporation increasing its R&D expenditures in Ontario by one dollar would incur an after-tax cost of 40.6 cents, after federal and provincial tax expenditures are taken into account. This level of tax support is generous relative to that provided by other countries.
- The 1988 Ontario Budget increased the level of tax support for R&D with the introduction of the Research and Development Super Allowance, at an estimated cost in revenue foregone of $45 million in the first full year.

- In addition to tax support, direct funding of business R&D by government grants and contracts accounted for 8.7 per cent of R&D performed by Ontario businesses in 1986.

Continued improvement in R&D-related activities in Ontario will lead to higher investment, higher productivity, improved competitiveness and higher output.

**ONTARIO RESEARCH AND DEVELOPMENT EXPENDITURES AS A SHARE OF CANADA 1979 - 1986**

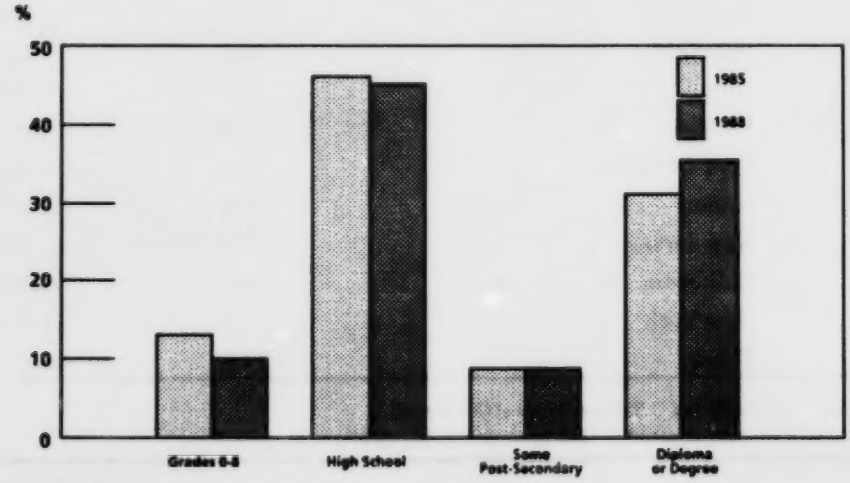



Source: Statistics Canada.

*Skilled Labour Force*

Education levels are high and continually improving as increasing numbers of Ontario students pursue post-secondary education programs. The share of the adult labour force with a completed college or university education rose from 31.3 per cent in 1985 to 35 per cent in 1988.

**ONTARIO'S ADULT LABOUR FORCE BY EDUCATIONAL ATTAINMENT 1985 AND 1988**




Source: Statistics Canada.

There are 12 universities with engineering programs in Ontario. Annually, about 3,100 bachelors degrees, 700 masters degrees and 150 doctorates are awarded in the field of engineering. In addition, Ontario colleges of applied arts and technology graduate about 14,000 business and technology students each year. The province also benefits from the high average level of professional and technical skills of international and interprovincial migrants.

*Skills and Supplier Base*

Ontario, with over 50 per cent of Canadian manufacturing, has a higher industrial concentration in manufacturing (25.5 per cent of gross provincial product) than the U.S. as a whole (19.7 per cent) and all but four of the largest states in the United States.

Ontario's supplier base for manufacturing is particularly strong, given the province's strength in industries such as auto parts, steel, machinery, electrical and electronics, metal fabrication, plastics and chemicals. Toronto as a centre for high quality business and financial services is also a significant advantage to provincial manufacturers.

Manufacturing employment accounts for over 20 per cent of total Ontario employment. This share ranks with those of the largest U.S. states. To a prospective investor, a large employment base in manufacturing indicates an experienced industrial workforce, as well as a significant potential supply of skilled trades. Interprovincial and international migration into Ontario responds quickly to tight labour markets, giving Ontario's labour market a high degree of flexibility. In addition, Ontario's extensive training investments and its mobile labour force provide a continuing source of highly qualified workers for the manufacturing sector.

**Manufacturing Employment: Ontario Compared to Ten Largest U.S. States, 1988** **Table 7**

| Rank | State | Share (%) of Total Employment | Manufacturing Employment (000's) |
|---|---|---|---|
| 1 | North Carolina | 27.0 | 862.5 |
| 2 | Indiana | 23.9 | 630.2 |
| 3 | Michigan | 22.2 | 930.3 |
| 4 | Ohio | 22.2 | 1,099.1 |
| **5** | **Ontario** | **21.2** | **1,034.0** |
| 6 | Pennsylvania | 19.3 | 1,050.3 |
| 7 | Illinois | 17.6 | 945.0 |
| 8 | New Jersey | 17.4 | 667.6 |
| 9 | California | 16.1 | 2,139.5 |
| 10 | New York | 15.0 | 1,218.2 |
| 11 | Texas | 12.3 | 944.2 |

Source: Statistics Canada and U.S. Department of Commerce.
Note: Based on January-September 1988 average monthly employment.

*Public Infrastructure*

**Industry in Ontario benefits from a comprehensive network of public infrastructure. The provincial highway system, comprising 21,000 kilometres, is extensive and toll-free. In addition, airports, railways and marine transportation systems further enhance the movement of goods and people. Wide-ranging and comprehensive telecommunication systems facilitate the transfer of information and data throughout the province. For the past four fiscal years, including 1988-1989, $10.1 billion has been allocated by the Province for budgetary capital expenditures for areas such as transportation, health, education and the environment.**

## The Medium Term and Sector Outlook

### Sustained Moderate Growth

**The Canadian and Ontario economies will continue to expand through the medium term, but at a much slower pace than in recent years, reflecting primarily slower growth of the labour force.**

**The Ontario Economy: 1990-1992** **Table 8**
(Annual Average)

| | |
|---|---|
| Real Growth (%) | 2.7 |
| Inflation (%) | 4.8 |
| Job Creation (000s) | 102 |
| Unemployment Rate (%) | 5.0 |

Source: Ontario Ministry of Treasury and Economics.

Over the 1990-1992 period:

- Real output growth will average 2.7 per cent per year;
- Employment will grow by 2.0 per cent or 102,000 jobs annually;
- Productivity will increase by 0.6 per cent per year;
- The inflation rate will average 4.8 per cent; and
- The unemployment rate will average 5.0 per cent.

## Medium Term Sector Outlook

Led by the transportation equipment sector -- with expected output growth of 3.8 per cent annually -- Ontario's industrial sectors will continue the broadly based expansion over the medium term. In line with the economy as a whole, manufacturing output growth will be slower than it has been in the recent past.

**Sector Outlook for Ontario** **Table 9**

| | 1987 | | Real Output Growth | | |
|---|---|---|---|---|---|
| | Employment | Real Output | 1988 | 1989 | 1990-92 |
| | (000s) | (1981 $ Million) | % | % | % |
| **Goods Producing Sector** | **1,547** | **58,701** | **4.4** | **2.6** | **2.7** |
| Primary | 182 | 6,201 | 2.2 | 5.0 | 2.2 |
| Manufacturing (total)* | 1,038 | 38,196 | 4.6 | 1.9 | 2.8 |
| Resource-Based | 152 | 5,683 | 1.5 | 0.7 | 1.4 |
| Industrial Products | 378 | 15,362 | 4.7 | 2.6 | 2.4 |
| Transportation Equip. | 190 | 7,445 | 9.1 | 0.7 | 4.9 |
| Consumer Products | 275 | 8,485 | 2.6 | 2.5 | 2.4 |
| Construction | 274 | 10,602 | 5.2 | 3.1 | 2.5 |
| Utilities | 53 | 3,703 | 3.6 | 4.1 | 3.3 |
| **Service Sector** | **3,159** | **90,493** | **4.6** | **3.1** | **2.6** |
| **Total** | **4,706** | **149,194** | **4.5** | **2.9** | **2.7** |

Note: *Includes miscellaneous manufacturing.
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

## Manufacturing Sector Outlook

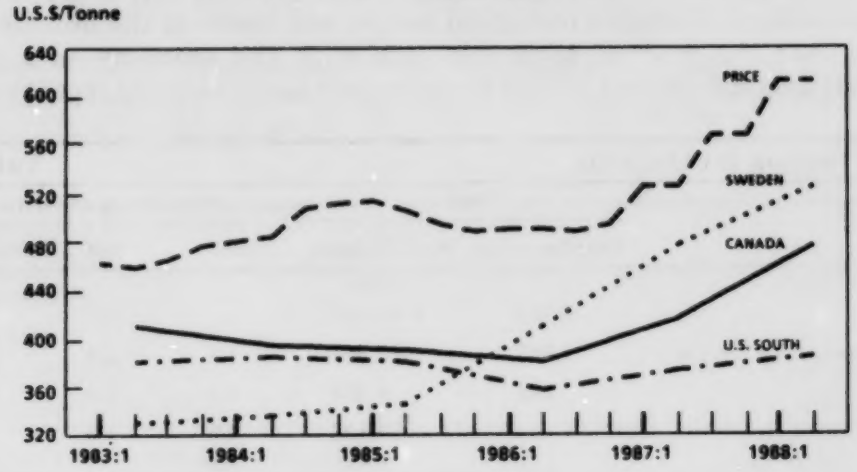
*Resource-Based Manufacturing*

Resource-based manufacturing includes pulp and paper, wood products and primary metals. This sector accounts for 15 per cent of Ontario manufacturing output and represents 35 per cent of Canada's resource-based manufacturing output.

In 1988, **pulp and paper** prices, production and profits all continued to rise. At current prices, both kraft pulp and newsprint producers are enjoying substantial profit margins; however, these margins are very sensitive to the exchange rate. At current exchange rates, Canadian producers generally have higher costs than their U.S. competitors; however, their competitive position has improved vis-à-vis Scandinavian producers.

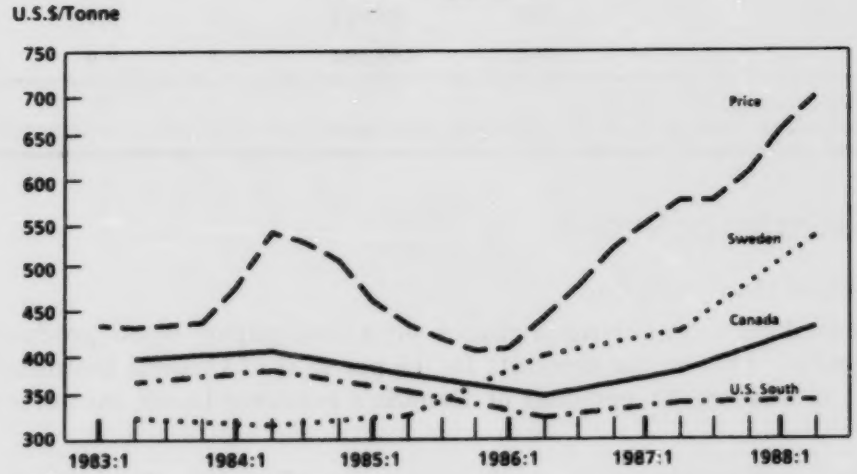
Prices are expected to begin levelling off in 1989. Production is expected to increase only slightly, owing principally to expansion in printing and writing papers at Dryden and Sault Ste. Marie. Beyond 1989, prices are expected to fall as new North American production capacity temporarily outstrips demand growth.

**NEWSPRINT PRICE AND PRODUCTION COSTS**
**1983-1988**




Source: Scotiabank and Papertree Letter.

**KRAFT PULP PRICE AND PRODUCTION COSTS**
**1983-1988**




Source: Scotiabank and Papertree Letter.

Ontario sawmills, faced with a 15 per cent tax on softwood lumber exports to the U.S., have directed more of their sales to markets within the province; nonetheless, overall shipments still declined by about 2 per cent in 1988. Waferboard producers are also facing difficulties as a result of new capacity in North America, which has depressed prices.

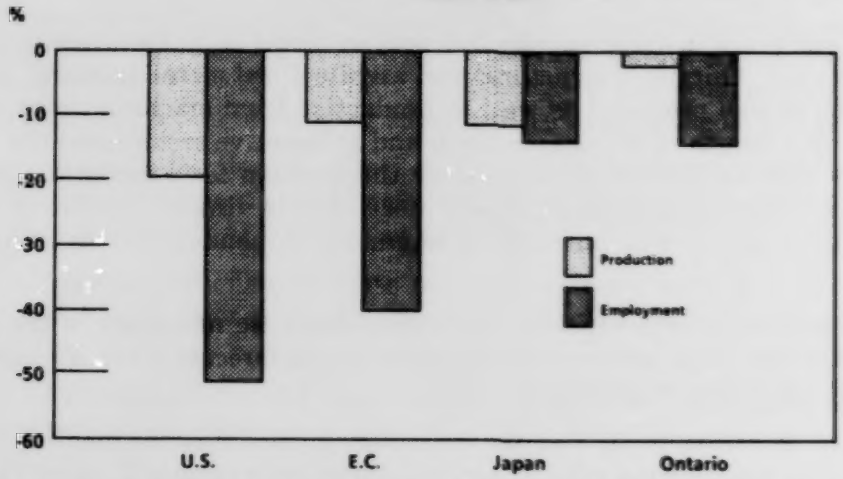
A further decline in housing starts in both Ontario and the U.S. and the rise in the Canada/U.S. exchange rate since mid-1987, will adversely affect the wood products industries in 1989. Slow growth is expected in the 1990-92 period.

Higher base metal prices are providing a strong stimulus to the primary metals industry whose major components are the iron and steel industry and nickel and copper smelters. In the short-term, a healthy expansion in production is expected. Over the medium term, this sector will record more modest rates of growth.

Ontario's steel manufacturing facilities have become some of the most modern and efficient operations in the world. The worldwide downsizing of the steel industry throughout the 1980s has had a much smaller impact on production and employment levels in Ontario than in the U.S. and other OECD countries.

Dofasco's purchase of Algoma Steel makes it the largest steel producer in the country and the fourth largest in North America. Dofasco, which is operating at capacity, will gain access to Algoma's excess steel-making capabilities and an opportunity to expand its product lines.

**REDUCTION IN RAW STEEL PRODUCTION AND EMPLOYMENT FOR SELECTED COUNTRIES 1980-1987**




Source: Statistics Canada, American Iron and Steel Institute, O.E.C.D. and Ontario Ministry of Treasury and Economics.

In an environment of growing domestic demand, tight supply, and rising industry prices and profits, Ontario's steel producers are enjoying another year of vigorous activity. While output will remain high, slower rates of economic growth, declining use of steel and a tapering off in construction sector demand will result in little expansion over the 1989-1992 period.

*Industrial Products*

Industrial product manufacturers include electrical and electronic products, machinery, fabricated metals, non-metallic minerals (for example, cement, concrete, clay, glass), plastics, chemicals and petroleum refining. They account for about 40 per cent of manufacturing production in Ontario and 57 per cent of the national total.

As a result of continued economic expansion, modernization in many industries, healthy profit growth and strong business investment spending, the level of real

economic activity in the industrial products sector expanded by an estimated 4.7 per cent in 1988. Growth is expected to continue over the medium term.

Growth in the **electrical and electronic products** sector is being driven by buoyant construction and business investment and the need to modernize production facilities and improve productivity. As a result, sales have been strong for producers of household appliances, office, store and business machines and lighting fixtures. However, with softening in consumer expenditures and housing sector activity and the higher exchange rate affecting both exports and imports, growth is expected to moderate.

The **machinery** industry has rebounded strongly since the recession. In 1987, machinery producers experienced strong demand, with real shipments advancing by about 10 per cent. Machinery sales in 1988 have been helped by increasing levels of business investment in plant and equipment. Also, strength in the resource sector bodes well for makers of mining equipment and pulp and paper machinery. However, overall sales growth will moderate as business investment spending moderates over the forecast period.

The strong advance in shipments by **fabricated metal** manufacturers in 1987 has eased this year. Output of structural and architectural metal products, stamped, pressed and coated products, as well as production from machine shops, is being bolstered by strength in the construction and automotive sectors and the boom in machinery and equipment outlays. Over the medium term moderate growth is forecast. Industry segments that are more closely linked to non-residential business investment will outperform segments dependent on housing sector activity.

The rapid pace of growth experienced by **non-metallic minerals** in the last two years is expected to become more moderate over the forecast horizon as growth in residential construction activity slows.

**Plastics** will continue to register above average growth over the medium term. In addition to normal demand growth, technological innovation will allow plastics to replace traditional materials in a variety of applications.

The dramatic turnaround in the profitability of the **chemicals** industry, which began in 1986, continued through 1987 and 1988. The petrochemicals industry has been particularly strong. This sector was hard hit by the recession and massive additions to capacity in major oil-producing countries.

The industry is now benefitting from extensive worldwide rationalization and rising demand. Overall capacity utilization is close to 95 per cent in Canada and for certain intermediate and final products it is nearing 100 per cent. As well, the realignment of international currencies has strengthened the competitive position of North American firms in world markets. The rise of the Canadian dollar vis-à-vis the U.S. dollar over the past year has begun to exert competitive pressure on some Canadian firms, particularly in the organic chemicals and specialty chemicals sector. On the whole, however, the industry is expected to maintain satisfactory levels of profitability.

Demand for **refined petroleum products** continued to increase in 1987 and 1988, though more slowly than the economy as a whole. While demand has increased

due to Ontario's population growth and economic expansion, growth has been dampened by continued conservation efforts and the substitution of alternative fuels, mainly natural gas, in heating applications.

As a consequence of the extensive capacity rationalization of the early 1980s, plant utilization rates remain high, at around 92 per cent. With minor investments, capacity should be adequate to meet demand over the next three to four years. Demand is anticipated to grow at about 1 per cent per year over this period. The industry is expected to advance investment plans in order to meet the December 1, 1990 deadline for the elimination of lead additives from automotive gasoline.

*Transportation Equipment*

The transportation equipment industry is composed of motor vehicle assembly and parts, other transportation equipment (such as airplanes, buses, and railway equipment), and rubber products. Ontario produces about 80 per cent of the national output in this sector. Transportation equipment contributes about 20 percent of Ontario's manufacturing output.

Motor vehicle assembly and parts dominate the transportation equipment industry; they account for over two-thirds of provincial output and employment in the sector. Ontario exports 80 per cent of its motor vehicle production, and has a greater export orientation than either Japan (52 per cent) or the U.S. (8 per cent).

Ontario's auto production declined during 1986 and 1987 as a result of shutdowns for plant conversions, slower than anticipated start-ups at several new plants, and a slowdown in U.S. sales during 1987.

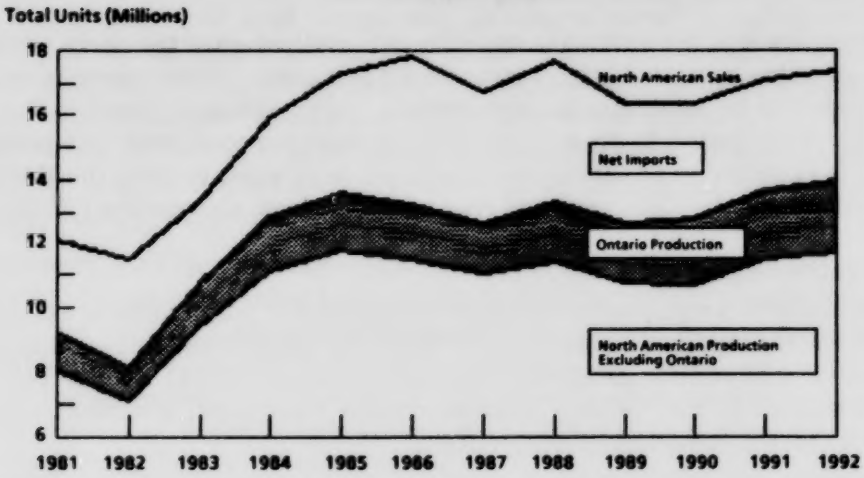
For 1988, Ontario production of motor vehicles has rebounded to a record level, reflecting both higher sales of North American built cars and increased production capacity in Ontario.

The effect of a softening of U.S. vehicle sales during the latter part of 1989 is expected to be largely offset by increasing output from Ontario's new and cost-efficient plants.

During 1988, imports declined as a share of North American sales. This was the result of both expanded production by offshore owned capacity (primarily Japanese production in North America) and the impact of currency realignments. In the medium term, North American auto production is forecast to increase in line with a gradual recovery in North American sales and some improvement in North America's trade balance with the rest of the world.

The improving trade balance is the result of currency realignments and auto industry investments in North America, especially in Ontario, which have greatly enhanced competitiveness. Increased production from North American transplants and joint ventures will displace some imports, and, in some cases, lead to increased exports to Europe and Japan. Ontario production of cars and trucks is expected to exhibit good growth, as Ontario will continue to increase its share of North American production.

**ONTARIO AND NORTH AMERICAN MOTOR VEHICLE PRODUCTION**
**1981 - 1992**




Source: Ward's Automotive Reports and Ontario Ministry of Treasury and Economics.

Since the health of the Ontario **motor vehicle parts** industry is directly tied to the level of North American motor vehicle production, it, too, experienced significant growth in output and employment following the downturn in the early 1980s. However, the auto parts industry is undergoing considerable restructuring in response to shifts in production technologies and methods and increased international competition.

The Ontario motor vehicle parts industry is expected to grow over the next several years along with North American vehicle production expansion. The industry is benefitting from its orientation to the rapidly growing Canadian assemblers. However, with a higher Canadian dollar, parts industry growth will be somewhat slower than in the recent past.

Recent closures of major tire plants have reduced output in the **rubber industry** in 1988. Lost output will be regained when new investments in plant and technology come on stream, such as Goodyear's new $320 million plant in Napanee. These investments are expected to lead to renewed growth in the industry over the 1990-92 period.

In the **non-automotive transportation equipment** sector, aircraft manufacturing is expected to grow strongly as airlines replace aging equipment.

*Consumer Products Industries*

Consumer products industries include food and beverages, textiles and clothing, household furniture, and printing and publishing. Ontario produces 48 per cent of the national output in this sector. Consumer products constitute 22 per cent of total provincial manufacturing. Consumer products industries are forecast to increase output by an average of 2.4 per cent annually between 1988 and 1992.

The performance of the **food processing** sector this year will be partially affected by the poor harvest. Assuming a more normal harvest next year, production

should rebound. Output is closely tied to population growth. As a result, relatively slow growth is expected to continue.

The **beverage** industry has exhibited moderate growth, somewhat faster than population trends. This is expected to continue for the medium term. Alcoholic beverages will show the least growth, due to a continued market decline for the spirits industry.

The **tobacco manufacturing** industry has completed a major restructuring and downsizing and is expected to show only modest declines over the next four years.

As a result of a concentrated modernization program, the Canadian **textile industry** is among the most technologically up-to-date in the world. Over the past decade, this modernization has reduced Ontario's textile employment by 8 per cent, while production has grown by 86 per cent. As the economy grows at a more moderate pace in the medium term, the textile industry, including fabrics for clothing, furniture, drapes, and carpeting, is expected to grow more slowly.

By contrast, employment in the **clothing** industry has grown by 23 per cent over the last ten years, with the most rapid growth in Eastern Ontario and the Toronto area. Future prospects are for slower growth, reflecting more restrained spending by consumers, and constraints on industry expansion because of a tight labour market.

Near record house construction, renovations, and healthy office furniture exports to the U.S. have helped Ontario's **furniture and fixture** output grow by 5.6 per cent a year in the 1985-88 period. Future growth is expected to moderate in line with slower household and business spending.

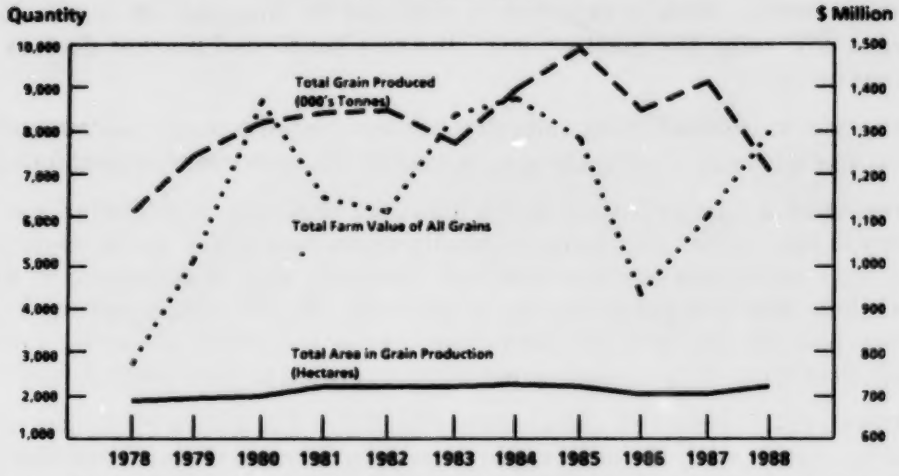
In the last four years, the **printing and publishing** industry has been growing at 4.6 per cent per year. The outlook is for continued growth. Competition from the explosion of in-house photocopying, printing and desktop publishing will result in continued emphasis on cost reduction and technological improvements.

## Primary Sector Outlook

### *Agriculture*

Drought in the major producing areas of the U.S., Western Canada and Southwestern Ontario has had a significant impact on agriculture. Total real output in 1988 is expected to be down by 3.8 per cent from 1987, primarily as a result of a substantial decline in grain production.

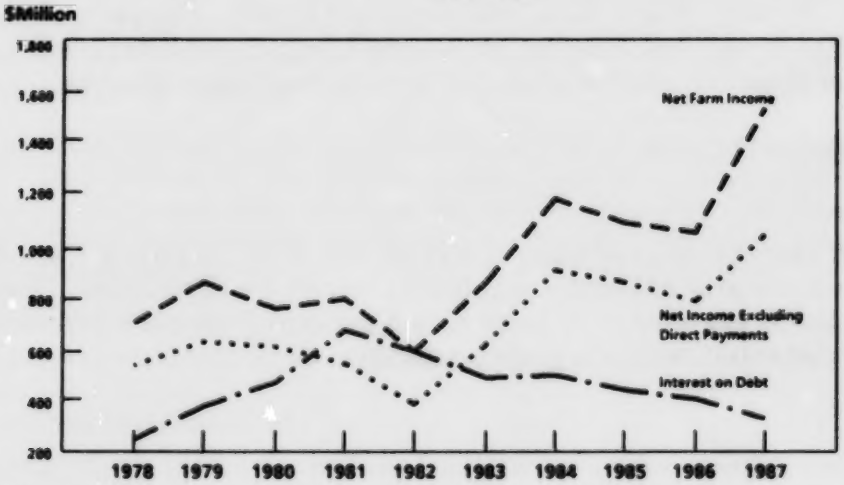
**ONTARIO GRAIN PRODUCTION:
AMOUNT, AREA AND FARM VALUE
1978-1988**




Source: Statistics Canada, Ontario Ministry of Agriculture and Food and Ontario Ministry of Treasury and Economics.

However, higher prices for grains brought about by the drought will result in an increase in receipts for grain shipments as well as for total gross farm revenues in 1988. These higher revenues should further support the trend towards reduced debt and debt servicing costs.

**ONTARIO NET FARM INCOME AND THE COST OF DEBT
1978-1987**




Source: Statistics Canada.

Over the next four years, real agricultural output is expected to grow at an average annual rate of 2.7 per cent.

In 1989, cereal and oilseed production should show an increase as farmers respond to higher prices and given a return to more typical growing conditions. Over the

medium term, a return to large world grain surpluses and lower prices may be expected.

Red meat production should remain reasonably constant at least until late in the outlook period, when declining feed costs and rising red meat prices should encourage some expansion in the industry.

No real growth in fruit and vegetable production is expected. This is primarily due to import competition, labour shortages and a planned reduction in grape acreage under a joint federal-provincial program.

The 1988 target for the Ontario tobacco harvest is 141 million pounds, up from 110 million pounds in 1987. Stronger domestic prices, foreign demand and a three-year purchasing accord with tobacco manufacturers will help stabilize the industry.

*Forestry*

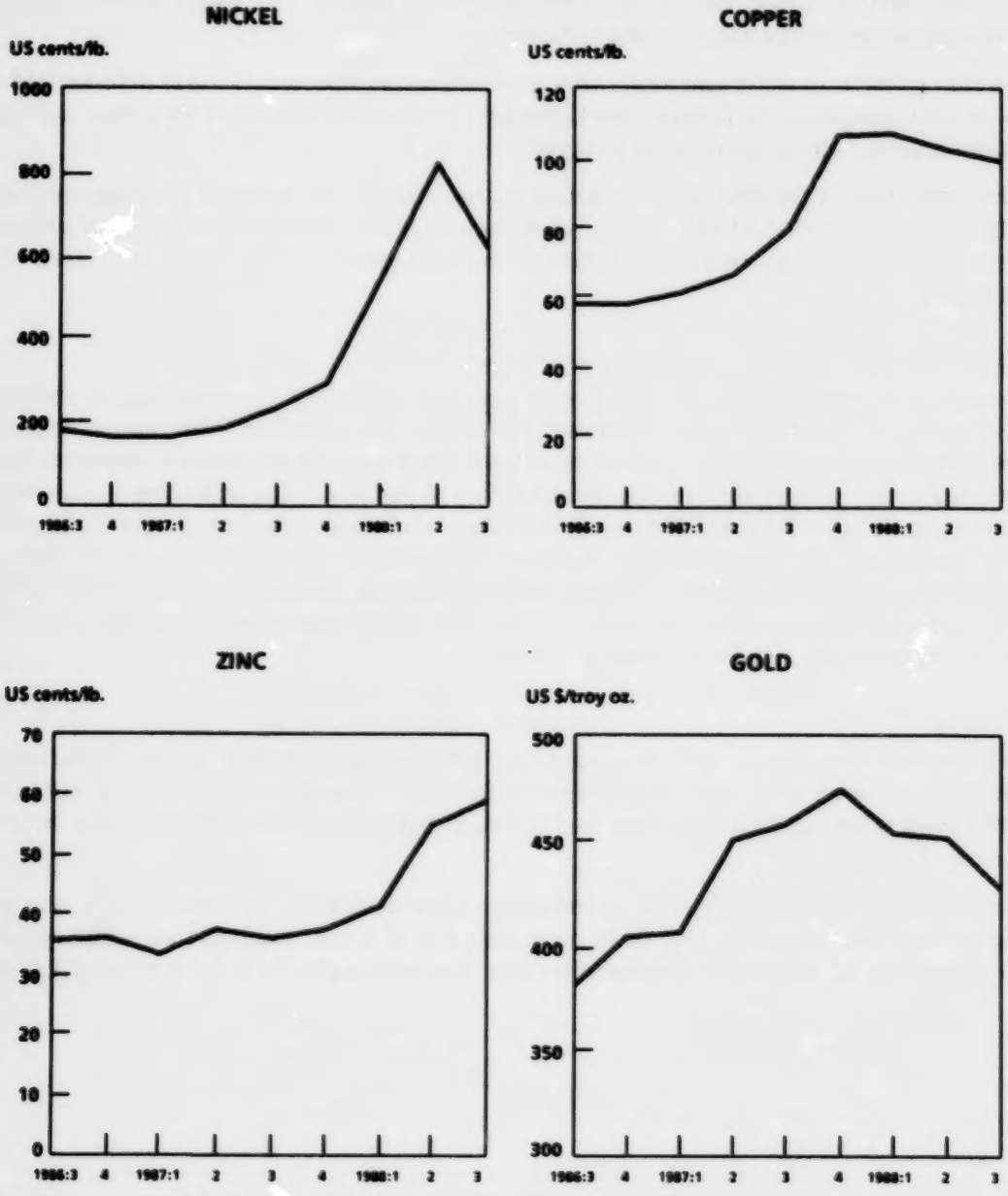
Roundwood production by Ontario's logging industry is expected to decline slightly from the 1987 peak of some 26.4 million cubic meters. Increased demand for wood by pulp mills in 1988 was more than offset by decreased demand from sawmills and waferboard mills. In an effort to reduce costs, mills have also been reducing mill-yard wood inventories in the past few years. Logging activity was also curtailed by forest fires in much of Northern Ontario this year. A further reduction in logging activity is expected in 1989, as demand by pulp mills levels off, and additional cutbacks occur in the output of sawmills. Over the medium term, logging activity is expected to stabilize.

*Mining*

While gold has dominated mining news for the past several years, base metal markets showed the most improvement in 1988. Unexpectedly strong demand, combined with limited supplies, has led to substantial price increases for nickel, zinc and copper.

Employment in Ontario's mining industry, after declining for many years, showed significant increases in the first nine months of 1988: exploration employment increased by 52, mine development by 505, and mining by 517, for a total of 1,074.

## METALS PRICE PERFORMANCE
## 1986-1988




Source: Energy, Mines and Resources Canada.

Although gold prices trended downward during 1988, production costs at most Ontario mines are in the range of U.S. $150-$300 per ounce, well below gold's current price of about U.S. $420 per ounce. Eight new gold mines have come into production in the past two years; several others are under development or in the advanced exploration stage. Gold production increased by some 15 per cent this year, and will increase further in 1989.

With 1988 nickel prices about double last year's levels, nickel will again be Ontario's most important mineral. Robust demand from domestic stainless steel manufacturers and Pacific Rim countries should ensure continued strength in 1989.

Zinc market conditions are favourable as demand for galvanized steel remains strong and supplies are tight. Minnova's Winston Lake mine started up in 1988 and will be one of the few new additions to world zinc capacity until mid-1990. Copper should continue to experience increasing demand in 1989, but price increases will be held back by supply increases in the U.S. and Chile.

While uranium prices changed little during 1988, western world consumption exceeded supply for the first time in several years, suggesting improving market conditions.

In general, the medium term outlook for metals is favourable, reflecting continued global economic expansion.

## Construction Sector Outlook

The construction sector has enjoyed very rapid growth in recent years. The industry has benefitted from the strong demand for housing and from commercial and industrial developments. Since 1985, employment in construction has grown by over 50,000 jobs -- an increase of 23 per cent. The industry's real output is estimated to have increased by 30 per cent from 1985 to 1988.

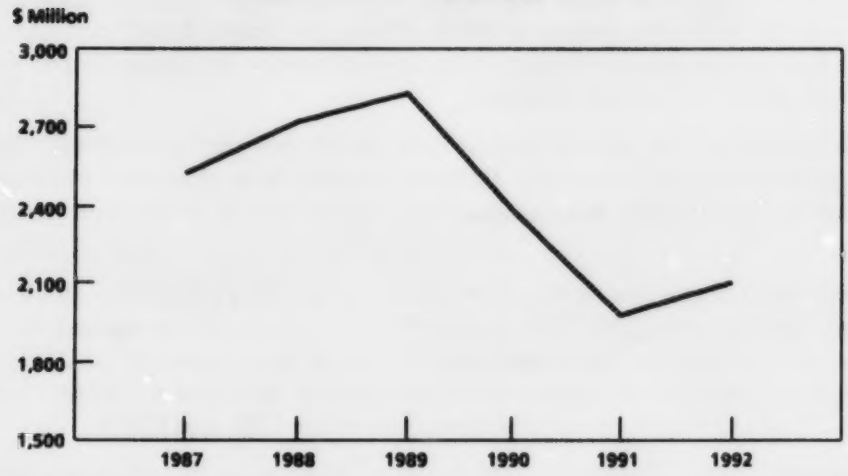
In 1989, business investment will continue strong, and real growth in the construction sector will match growth for the economy as a whole. Over the period 1990 to 1992, slower economic growth, the stabilization of housing starts and a reduced backlog of commercial and industrial projects will reduce construction industry growth to a rate slightly below that of the overall economy.

## Utilities Sector Outlook

The utilities sector, composed mainly of electricity generation and gas distribution companies, is closely aligned with the energy requirements of the economy. The utilities sector output is expected to grow modestly over the forecast horizon, reflecting the more moderate growth in population, household formation, and the overall economy.

Investment is dominated by Ontario Hydro, which accounted for roughly 80 per cent of total investment in the utilities sector over the past five years. With the near completion of four units at the Darlington Nuclear Station, investment in electricity generating facilities will decline gradually to 1991. With the completion of Darlington, Ontario Hydro's installed capacity will increase to 33,952 megawatts, compared to 30,087 in 1988.

ONTARIO HYDRO'S CAPITAL INVESTMENT OUTLOOK
1987-1992




Source: Ontario Hydro.

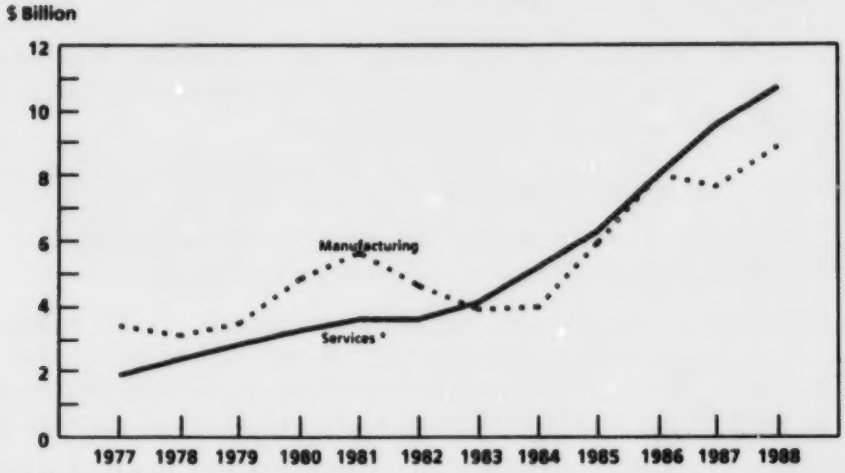
## Service Sector Outlook

Many different kinds of businesses and activities make up the service sector, including banking, retail stores, health care, education, trucking, television stations and accounting. Taken as a whole, these activities comprise the largest component of the provincial economy. Output from services is now 61 per cent of total Ontario output. Employment in services is 68 per cent of all Ontario employment.

In recent years, growth of service sector output has been roughly comparable to the growth in output for the goods-producing sector. Service sector industries are less strongly cyclical than goods-producing industries. Consequently, as the economy moves to slower growth in 1989, service sector output growth is expected to be somewhat stronger than output growth for goods-producing industries. However, over the period from 1990 to 1992, service sector output growth will once again approximately match growth for the economy as a whole.

Expenditures on buildings and machinery by the service sector are an increasingly important part of total business investment. Until the early 1980s, capital expenditures in manufacturing exceeded by a significant margin those for a key group of service industries -- trade, finance and commercial services. Since 1983, this position has been reversed. Estimated capital expenditures in Ontario for 1988 are $8.9 billion for manufacturing and $10.7 billion for trade, finance and commercial services.

**CAPITAL EXPENDITURES IN MANUFACTURING AND KEY SERVICES IN ONTARIO 1977-1988**




* Trade, Finance and Commercial Services.

Source: Statistics Canada.

As well, service sector industries are as active as manufacturers in taking advantage of new technologies. In 1985, 13 per cent of manufacturing expenditures on machinery and equipment were for computers and robotized equipment. Sixteen per cent of expenditures by the finance, trade and commercial services sector were in these high-technology categories.

Productivity growth has tended to be relatively slow in the service sector. However, given the recent investment performance of service industries and their adoption of new technologies, the productivity performance of the service sector should improve over time.

## Tourism Sector Outlook

Tourism is a major generator of employment, accounting for 4.2 per cent of Ontario jobs. The industry is expected to continue to perform well in 1989, generating some $9.8 billion in tourist expenditures. This follows an exceptionally strong performance over the past three years. International currency realignments will encourage further expansion in the overseas market this year, while there may be some reduction in the number of visitors from the United States.

Demographic and consumer trends point to continued expansion in the tourism market over the medium term. Continued real income increases in industrial countries will result in steady growth of personal and business travel. Ontario is well positioned with its good image, diverse society, strong economy and unique natural attractions, to compete for a larger share of this global market.

# *Ontario Fiscal Review*

## Revenue Profile*

As of September 30, 1988, it is estimated that Provincial revenues will amount to over $36.2 billion. This section provides a brief overview of Ontario's revenue structure and describes some of its key characteristics.

### Composition of Provincial Revenues

The Province has a broad range of revenue sources including taxation, transfer payments from the federal government and other budgetary revenue.

The three major taxation sources -- personal income tax, retail sales tax and corporations tax -- contribute approximately 63 per cent of estimated 1988-89 budgetary revenue. Taxation of gasoline and diesel fuels contributes a further 4 per cent. In total, 71 per cent of 1988-89 revenue will be raised through taxation.

Transfer payments from the federal government account for 15 per cent of 1988-89 revenue. Due to federal actions that shift program costs and responsibilities to the provinces and federal limitations on the growth of Established Programs Financing transfers, this share shows a decline from 23 per cent of revenues in 1978-79.**

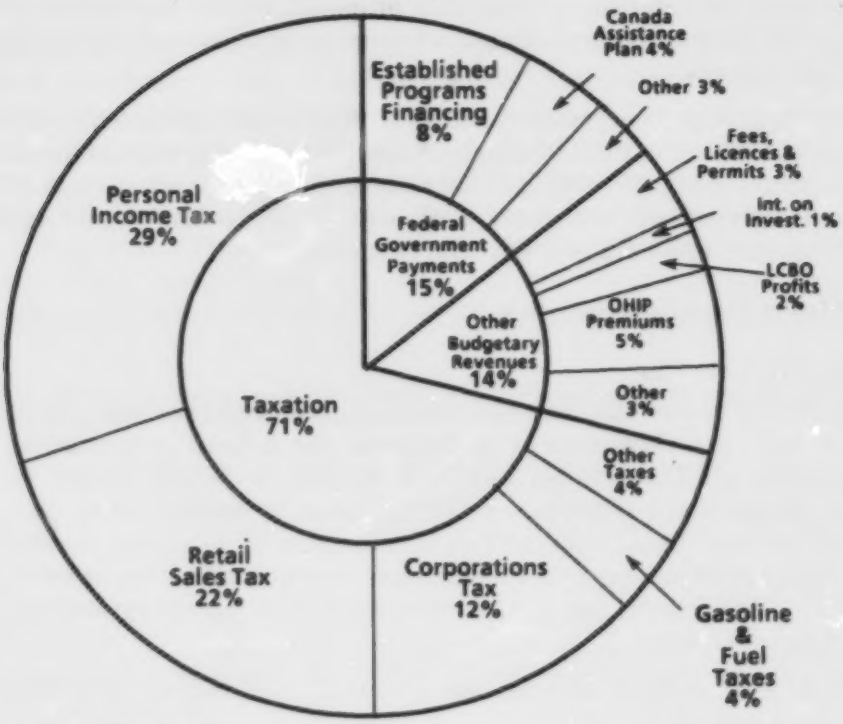
Other revenue sources include OHIP premiums, fees and licences, LCBO profits, interest on investments and lottery profit revenue. These sources will contribute 14 per cent of this year's revenue.

The following chart shows the Ontario budgetary revenue structure.

* All Ontario revenue figures for 1988-89 are based on the September 30, 1988 Ontario Finances.

** Includes $288.6 million one-time federal transfer for shared-cost economic package.

**COMPOSITION OF ONTARIO BUDGETARY REVENUES**
**1988-89***




* Forecast as of September 30, 1988.

Source: Ontario Ministry of Treasury and Economics.

## Canadian Tax Reform

In 1987 the federal government's White Paper on Tax Reform outlined two broad proposals for tax reform in Canada: reform of income taxes and reform of sales taxes. The federal government decided to pursue these reforms in two stages.

Stage I, corporate and personal income tax reform, was implemented this year. Central to these reforms is a reduction in the number and value of deductions and exemptions available to individuals and corporations, the conversion of certain exemptions and deductions to credits, and a reduction in tax rates. In addition, the ten personal income tax brackets have been reduced to three.

The 1988 Ontario Budget contained Ontario's response to Stage I. The effects of tax reform would have been to reduce provincial revenues and to impair the ability of some manufacturing and technology industries to compete. In response, Ontario adjusted its rates of personal income tax and increased the Ontario surtax on personal income tax payable in excess of $10,000 . In effect, the surtax applies only to individuals with incomes in excess of $85,000. To improve corporate competitiveness, Ontario introduced a Current Cost Adjustment for manufacturers and a Super Allowance for research and development. Also in response to reform, the Province redesigned its Ontario Tax Reduction and Ontario Tax Credit Programs.

Ontario, the other provinces, the territories and the federal government are engaged in discussions concerning a federal proposal for a joint national sales tax (Stage II of tax reform). Under this proposal, a new tax on value-added would replace the current federal Manufacturers' Sales Tax and the existing provincial retail sales taxes.

A working group of federal-provincial-territorial officials continues to examine the national sales tax option. Ontario is assessing the appropriateness of this option based on a variety of criteria. An important consideration is that the Province would be giving up a mature and well-administered retail sales tax which generates over one-fifth of Provincial revenues.

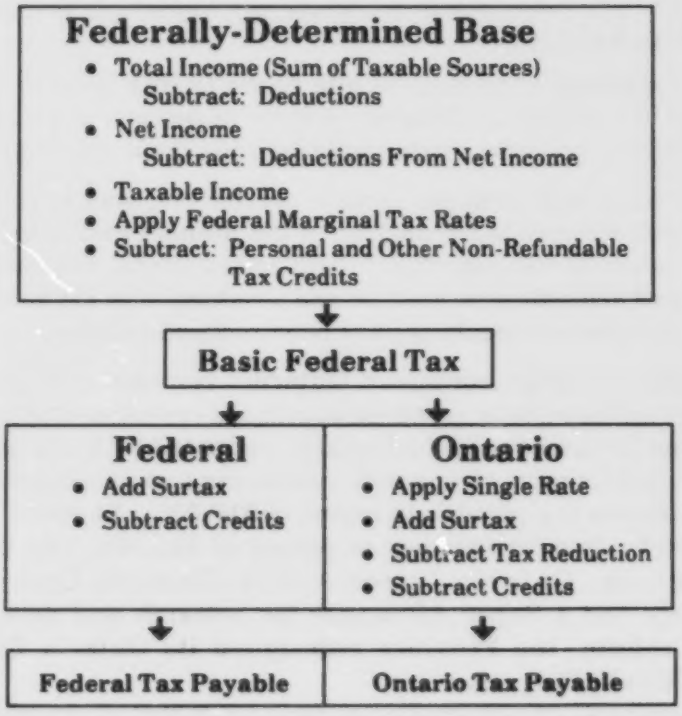
## The Major Taxation Sources

*Personal Income Tax*

Under the terms of the Tax Collection Agreement between the Government of Canada and the Government of Ontario, the federal government collects and administers the Ontario personal income tax on behalf of the Province. The federal government determines the tax base by establishing the definition of taxable income. Basic Federal Tax is calculated by applying the federal marginal rate structure to the taxable income base and deducting specified non-refundable credits. Total federal tax is then determined by applying federal surtaxes and other federal credits.

The diagram below illustrates the calculation of federal and Ontario personal income tax payable.

**THE PERSONAL INCOME TAX SYSTEM**



The federal marginal tax rates for 1988, including the 3 per cent federal surtax, range from 17.51 per cent on income in the lowest bracket to 29.87 per cent on income in the highest tax bracket.

Ontario personal income tax is defined as a percentage of Basic Federal Tax. For 1988, based on a statutory rate of 51 per cent of Basic Federal Tax, Ontario's personal income tax rates on taxable income range from 8.67 per cent to 14.79 per cent. The Provincial structure is shown in Table 1. In addition, a surtax of 10 per cent is applied to Ontario tax in excess of $10,000. The Ontario surtax increases the top combined federal and Ontario marginal tax rate of 44.66 per cent to 46.14 per cent. At the other end of the income scale, the Ontario Tax Reduction Program eliminates Ontario income tax payable of $150 or less for low-income taxpayers. Ontario income tax accounts for roughly one-third of an individual's total income tax.

**Federal and Ontario Marginal Personal Income Tax Rates, 1988** — **Table 1**

| Taxable Income | Basic Federal Rate | Federal PIT Rate* | Ontario PIT Rate** | Combined Federal/Ontario PIT Rates |
|---|---|---|---|---|
| $ | % | % | % | % |
| Up to 27,500 | 17.0 | 17.51 | 8.67 | 26.18 |
| 27,501 - 55,000 | 26.0 | 26.78 | 13.26 | 40.04 |
| Over 55,000 | 29.0 | 29.87 | 14.79 | 44.66 |

* Includes the 3% federal surtax.
** Does not include the Ontario Tax Reduction or the Ontario surtax.

With a few exceptions, such as social assistance payments and lottery winnings, all sources of income are subject to tax. Deductions and non-refundable tax credits are provided for certain personal and income-earning expenses. Provisions in the personal income tax system also support investment and saving for retirement as illustrated in the section on tax expenditures. Appendix I highlights the major tax expenditures* for these and other activities.

The Province provides special programs to relieve tax burdens on low-income Ontarians. Under the enriched $40 million Ontario Tax Reduction Program, as redesigned in response to federal tax reform, 350,000 low-income taxfilers will pay no Ontario income tax this year. There is no comparable federal tax reduction for low-income taxpayers. In addition, Ontario provides refundable property and sales tax credits through the Ontario Tax Credit (OTC) program. As a result of 1988 design changes, the new property and sales tax credits will deliver $444 million in tax credit benefits to over 1.8 million low-income Ontarians to ensure fairer property and sales tax burdens. Sales tax credits have been set at $100 per adult and $50 per child, more than doubling the total benefits for low-income households under this program last year. The combined net income of spouses and supporting individuals in a household will be used as the test for benefit eligibility under the OTC program. This improves fairness and progressivity by shifting

* Tax expenditures are specific incentives in the tax structure that reduce the normal amount of tax paid to a lower or zero amount. The value of a tax expenditure is calculated as the revenue foregone.

benefits from relatively higher income households to lower income households. Over 95 per cent of these tax credit benefits are received by Ontarians with incomes under $30,000.

*Corporate Taxes*

The Province of Ontario levies the following taxes specifically on the corporate sector: Corporations Income Tax, Capital Tax and Insurance Premiums Tax. Mining companies are also subject to the Mining Tax. All corporations in Ontario, with the exception of insurance companies, are required to pay capital tax based on their paid-up capital. Small corporations with taxable capital under $2 million pay zero or reduced capital tax but all larger corporations must pay tax on capital employed, regardless of income tax paid. The capital tax ensures that a minimum amount of corporate tax is paid by all large Ontario corporations. Insurance companies pay insurance premiums tax based on the amount of premiums received in respect of Ontario policies. Capital taxes and insurance premiums taxes are deductible expenses for federal and Ontario corporate income tax purposes.

The largest source of corporate tax revenue is the Corporations Income Tax. Ontario sets its own corporations income tax base and rate structure for the Province. Although significant differences have existed from time to time, Ontario's current base essentially parallels the federal corporate income tax base. Tax is imposed on gross corporate revenues earned in the taxation year less allowable expenses. Various corporate activities and investments receive special treatment through lower rates or accelerated deductions. These measures are estimated for corporations and listed in Appendix I.

The 1988 general corporations income tax rate is 15.5 per cent of taxable income. Income from manufacturing and processing operations, mining, logging, farming and fishing is taxed at the rate of 14.5 per cent. The 1988 small business tax rate in Ontario is 10 per cent.

The three-year exemption from Ontario corporate income tax for eligible small businesses is being phased out. Corporations that were carrying on active business prior to April 21, 1988 will continue to be exempt from income tax for their first three taxation years. The exemption will be discontinued for corporations incorporated after April 20, 1988.

Along with Ontario, Alberta and Quebec administer their own corporations income tax. All other provinces have entered into tax collection agreements with the federal government.

*Retail Sales Tax*

The retail sales tax is payable on the sale of most goods and on certain services. The tax is calculated as a specific percentage of the retail price to the consumer. The general retail sales tax rate is 8 per cent. Three other rates apply to specific goods and services: 5 per cent on transient accommodation; 10 per cent on admission fees over $4 and beverage alcohol products sold at licensed establishments; and 12 per cent on beverage alcohol products sold at retail outlets.

A number of goods are specifically exempt from retail sales tax. Exempt items include groceries, energy used for heating, cooking and lighting, children's clothing, footwear costing $30 or less, prescription drugs, specified reading material and production machinery and equipment. Most services are excluded from the retail sales tax base. The major retail sales tax expenditures are listed in Appendix I.

The Province determines both the retail sales tax base and rates. Registered vendors collect the tax as agents of the Province and remit it to the Government.

*Motive Fuel Taxes*

Ontario levies tax on motive fuels under the authority of two Acts: the Gasoline Tax Act and the Fuel Tax Act. Under both Acts, the tax base is applied to conventional petroleum-based products. Non-conventional fuels such as natural gas, propane, alcohol (used alone or blended with another fuel) and other manufactured gases are exempt.

Fuel taxes are levied on a per litre basis. The Provincial tax is 9.3 cents per litre on unleaded gasoline and 12.3 cents per litre on leaded gasoline purchased in Ontario. This tax applies to fuel used in licensed motor vehicles, snowmobiles and marine pleasure craft. Fuels used for heating and cooking and for off-road use in farming, commercial fishing and for industrial, commercial and institutional purposes qualify for exemption or full rebate of tax.

All aviation fuels purchased in Ontario are subject to a tax of 1.88 cents per litre.

Diesel fuel purchased in Ontario for use in licensed on-road motor vehicles is subject to tax of 9.9 cents per litre. As with the gasoline tax, certain off-road uses qualify for a full rebate of tax paid or are exempt at the time of purchase. A system of fuel colouration is in place to distinguish diesel fuel sold for exempt purposes, such as farming.

A tax of 3.1 cents per litre is applied to diesel fuel purchased in Ontario to power railroad locomotives.

## Per Point Yields

Table 2 shows the 1988-89 estimated revenue yield of selected taxes on a per point basis. The estimated yields are based on a full year's revenue and in each case the tax points relate to a specific base and unit of tax, such as percentage point of tax or litre of gasoline. For example, one percentage point of the general retail sales tax is estimated to yield approximately $915 million.

**Estimated Per Point Yield, 1988-89** **Table 2**
($ Million)

| | | |
|---|---|---|
| **Retail Sales Tax (RST)** | | |
| 8% - General | 915 | per percentage point |
| 5% - Transient Accommodation | 13 | per percentage point |
| 10% - Alcohol (Licensed Establishments) and Admission Fees | 17 | per percentage point |
| 12% - Alcohol (Retail Outlets) | 28 | per percentage point |
| **All RST rates** | **973** | **per percentage point** |
| Personal Income Tax (PIT) | | per percentage point |
| 8.67% - Taxable Income up to $27,500 | 1,061 | per percentage point |
| 13.26% - Taxable Income of $27,501 to $55,000 | 229 | per percentage point |
| 14.79% - Taxable Income over $55,000 | 106 | per percentage point |
| **All PIT rates** | **1,396** | **per percentage point** |
| Ontario (PIT) Surtax | 10 | per percentage point |
| Corporate Income Tax (CIT) | | |
| 15.5% - General | 97 | per percentage point |
| 14.5% - Manufacturing and Processing, Mining, Fishing, Logging and Farming | 88 | per percentage point |
| 10% - Small Business | 70 | per percentage point |
| **All CIT rates** | **255** | **per percentage point** |
| Capital Tax | 165 | per 1/10 point |
| Tobacco Tax | 10 | 1¢ per pack of 20 |
| Motive Fuel Taxes | | |
| Gasoline & Aviation Fuel | 143 | 1¢ per litre |
| Road and Rail Diesel | 38 | 1¢ per litre |
| **All Fuel tax rates** | **181** | **1¢ per litre** |
| OHIP Premiums (Individual and Family) | 59 | per $1/$2 a month |
| Land Transfer Tax (LTT) | | per 1/10 point |
| 0.5 % on first $55,000 | 19 | per 1/10 point |
| 1.0% between $55,000 and $250,000 | 38 | per 1/10 point |
| 1.5% above $250,000 (single family dwellings only) | 3 | per 1/10 point |
| **All LTT rates** | **60** | **per 1/10 point** |

Note: See text for interpretation of these data.
Source: Ontario Ministry of Treasury and Economics.

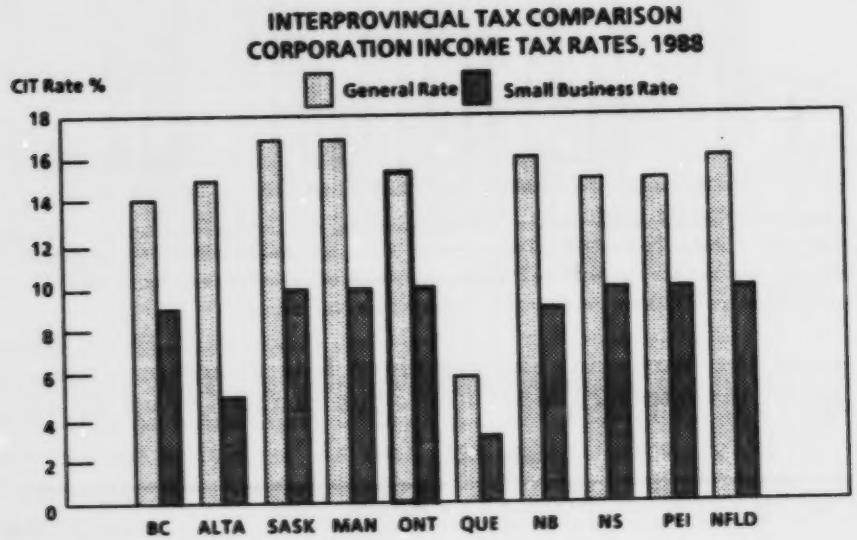
## Interprovincial Tax Rate Comparisons

Interprovincial tax rate comparisons must be viewed with caution. Differences in taxable bases are particularly important in interprovincial comparisons and are best illustrated by comparing the application of the retail sales tax. Significant interprovincial differences in retail sales tax exemptions exist for clothing, footwear, prepared food products, heating fuels and electricity, and transient

accommodation. Interprovincial differences also exist in the CIT treatment of various activities. For example, in respect of incentives for research and development, Ontario provides an extra deduction, called the Super Allowance, while Quebec provides tax credits. In the PIT area, some provinces apply tax credits, flat taxes, or surtaxes which affect both marginal and effective tax rates.

*Corporation Income Tax*

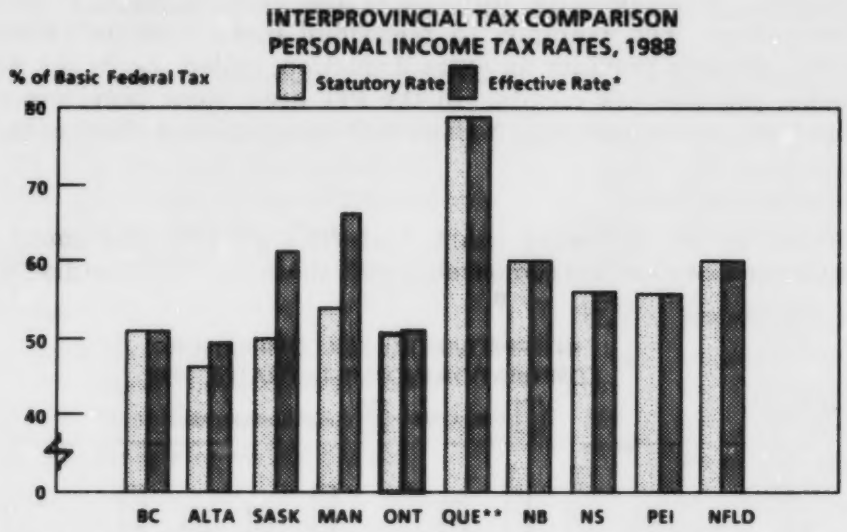
As illustrated in the following chart, Ontario's general and small business corporate income tax rates are comparable with those in most Canadian provinces.




Source: Ontario Ministry of Treasury and Economics.

*Personal Income Tax*

Provincial personal income tax rates and provincial personal income tax revenues as a percentage of Basic Federal Tax are illustrated below. Ontario's effective rate is 51.3 per cent, when the Ontario Tax Reduction Program and surtax are taken into account.




* Effective rate is total provincial income tax revenue (including any surtaxes and flat taxes, less any tax reductions) as a percentage of basic federal tax assessed in the province.

** Estimated rate; Quebec does not impose tax as a percentage of Basic Federal Tax.

Source: Ontario Ministry of Treasury and Economics and provincial tax statutes.

Table 3 shows the provincial and combined federal-provincial top marginal personal income tax rates for 1988. Ontario has the third-lowest top marginal tax rate.

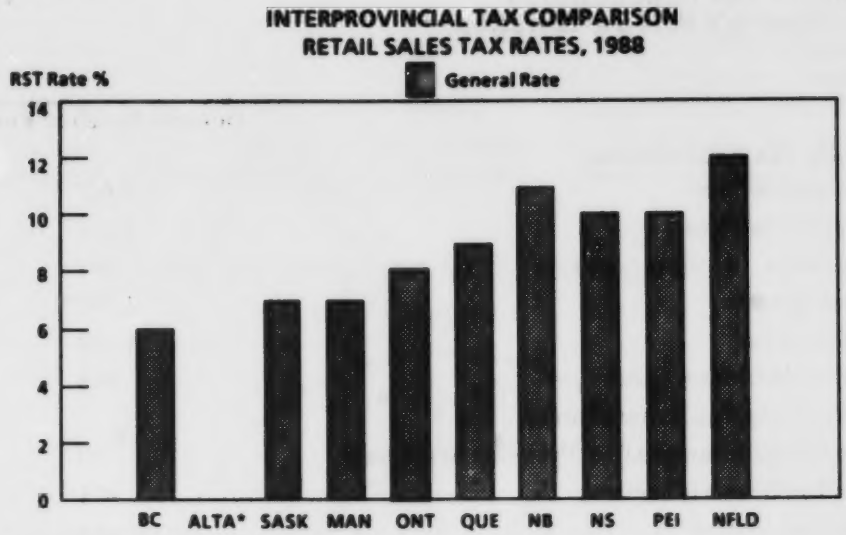
**Top Marginal Personal Income Tax Rates, 1988** **Table 3**

| | B.C. | Alta. | Sask. | Man. | Ontario | Quebec | N.B. | N.S. | P.E.I. | Nfld. |
|---|---|---|---|---|---|---|---|---|---|---|
| Provincial | 14.9 | 15.1 | 18.5 | 19.7 | 16.3 | 26.0 | 17.4 | 16.4 | 17.1 | 17.4 |
| Combined federal-provincial | 44.8 | 44.9 | 48.4 | 49.5 | 46.1 | 51.1 | 47.3 | 46.3 | 46.9 | 47.3 |
| Rank | 1 | 2 | 8 | 9 | 3 | 10 | 6 | 4 | 5 | 6 |

Source: Ontario Ministry of Treasury and Economics.

*Retail Sales Tax*

General retail sales tax rates in Canada range from zero per cent in Alberta to 12 per cent in Newfoundland. Ontario's rate of 8 per cent is in the mid-range of rates applied by all taxing jurisdictions.




* No provincial sales tax is imposed.

Source: Ontario Ministry of Treasury and Economics and provincial tax statutes.

## Tax Expenditures

Tax expenditures are taxes that governments choose not to levy in order to redistribute income more fairly or to encourage individuals and corporations to undertake desired activities. As such, tax expenditures are exceptions to the normal tax rules. Tax expenditures are often used as alternatives to direct spending to achieve particular policy objectives.

There are four types of tax expenditures: exemptions, deductions and allowances, credits, and special reduced rates of tax. All four are in use in Ontario's tax system.

Table 4 lists the ten largest tax expenditures within Ontario's jurisdiction, along with an estimate of revenue foregone for each expenditure. However, because many of these tax expenditures are interdependent, economists agree that these estimates should not be added together to derive a total value of foregone revenue. A more complete list of Ontario's major tax expenditures, along with a brief description of each, is contained in Appendix I.

**Ten Largest Tax Expenditures Within Ontario's Sole Jurisdiction in 1988-89**
**($ Millions)**

**Table 4**

| | Ontario Revenue Foregone |
|---|---|
| **Retail Sales Tax Expenditures** | |
| Professional Services | 3,657 |
| Commercial Services | 2,011 |
| Energy Goods | 1,687 |
| Personal Services | 1,682 |
| Basic Groceries | 1,102 |
| Production Machinery Goods | 818 |
| **Personal Income Tax Expenditures** | |
| Ontario Health Insurance Plan Premium Assistance* | 770 |
| Ontario Tax Grants to Seniors* | 471 |
| Ontario Tax Credits** | 444 |
| **Corporate Income Tax Expenditures** | |
| Small Business Deduction | 385 |

* Although not directly part of the Personal Income Tax system, these tax expenditures provide benefits to individuals.

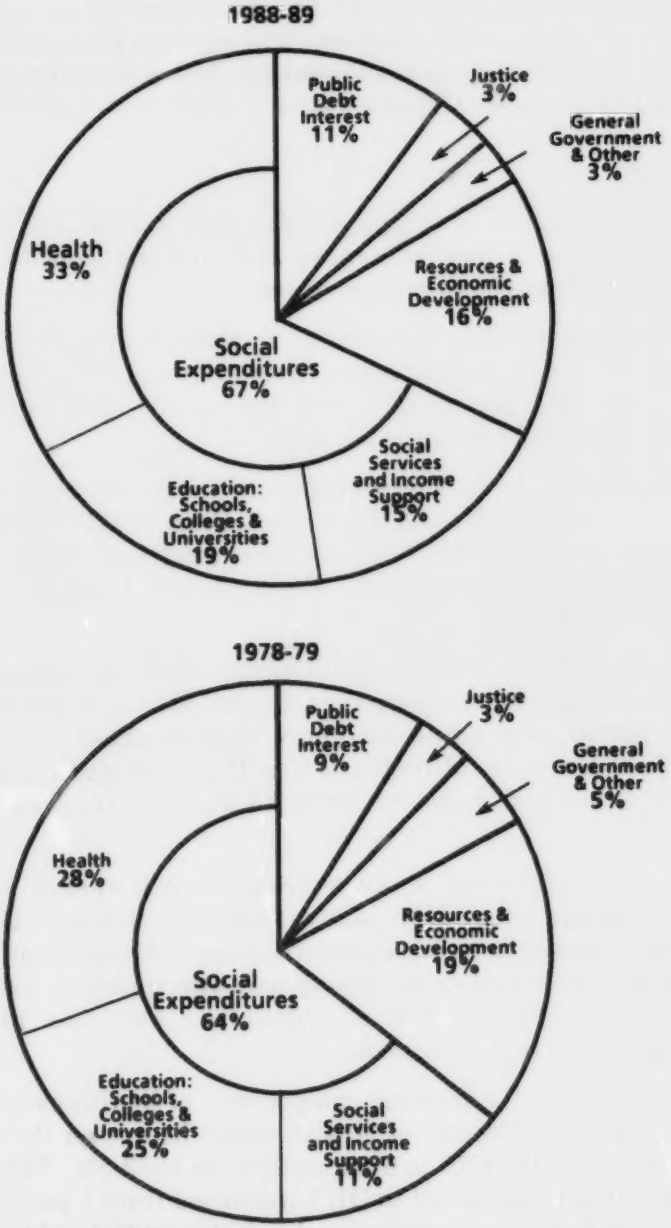
** Personal Income Tax expenditures are based on 1988 taxation year.

Source: Ontario Ministry of Treasury and Economics.

## Expenditure Profile

As of September 30, 1988, it is estimated that Provincial expenditures will amount to $37.9 billion in 1988-89. More than two-thirds of all Provincial spending is on social programs, with the balance allocated to economic development, justice, public debt interest, and other government activities. The charts below illustrate the proportion of government spending by major expenditure area in 1988-89 and 1978-79.

**DISTRIBUTION OF ONTARIO'S EXPENDITURES**




Source: Ontario Ministry of Treasury and Economics.

The charts indicate that there has been an appreciable shift in the composition of Provincial expenditures. The dominant feature of this shifting pattern is a notable

increase in the share of spending allocated to health care. The Ministry of Health is expected to account for 33 per cent of expenditures in 1988-89, compared to 28 per cent in 1978-79.

The proportion of Provincial spending allocated to social services and income support has also increased significantly. This area represented 11 per cent of spending in 1978-79, and accounts for 15 per cent of expenditures in 1988-89.

While an increasing share of expenditures is being taken up by health and social services and income support, the expenditure shares for education and for resources and economic development are being compressed. Education expenditures represented 25 per cent of Provincial spending in 1978-79, and are estimated to be 19 per cent in 1988-89. The share of Provincial spending dedicated to resources and economic development has fallen from 19 per cent in 1978-79 to an estimated 16 per cent in 1988-89.

## Health Care

The increasing share of spending dedicated to health care is of particular fiscal importance because it has influenced and will continue to affect the resources available for all other Provincial programs.

In the period from 1978-79 to 1988-89, health care expenditures increased at an average annual rate of 12 per cent. After allowing for population growth, which averaged 1 per cent per annum over the period, per capita health spending increased at a rate of 11 per cent per year.

The largest components of the overall health care program are the Operation of Hospitals, the Ontario Health Insurance Plan (OHIP) and the Ontario Drug Benefit Plan (ODB). In 1988-89 these three programs will account for 80 per cent of Ministry of Health expenditures. A more detailed look at health care funding is provided in Appendix II.

Expenditures for the Operation of Hospitals, the largest component of health care expenditures, increased at an average annual rate of 11 per cent over the 1978-79 to 1988-89 period. Spending has more than doubled from $2.0 billion to $5.5 billion. The share of the Ministry of Health budget dedicated to the Operation of Hospitals has declined, however, from 50 per cent in 1978-79 to 43 per cent in 1988-89.

OHIP costs have increased at an average annual rate of 15 per cent over the period, quadrupling total OHIP outlays from $1.0 billion in 1978-79 to $4.0 billion in 1988-89 and increasing the program's share of Ministry of Health expenditures from 26 per cent to 32 per cent. Rising utilization and an average annual 3.3 per cent increase in the number of physicians over the past ten years were contributing factors to this increase.

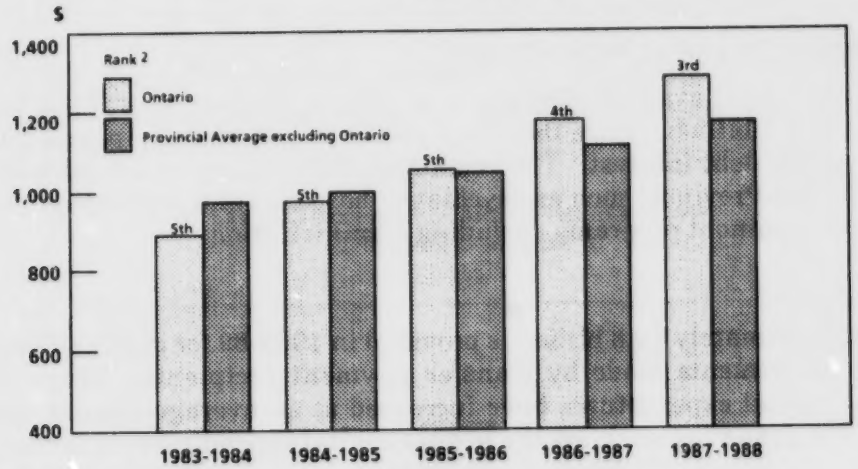
One of the most rapidly growing components of health care costs is the Ontario Drug Benefit Plan. Ministry of Health expenditures on the ODB plan increased from $89 million in 1978-79 to $569 million in 1988-89. The share of Ministry of Health expenditures allocated to ODB increased from 2 per cent to 5 per cent over the period. One factor accounting for this fast growth has been a rapid increase in the size of the eligible population. There are 35 per cent more seniors aged 65 and

over in the province in 1988 compared to 1978. An additional factor has been the sharply increasing average cost of claims.

The rapid rate of increase in health care expenditures in Ontario has resulted in a marked increase in Ontario's per capita health expenditures relative to per capita health spending in the other provinces. The following chart shows per capita health spending in Ontario compared to the average spending in the other nine provinces over the 1983-84 to 1987-88 period.

In 1983-84, Ontario's per capita health spending, at $896, was about 9 per cent below average spending in other provinces of $979 per capita. By 1987-88, however, Ontario's per capita level was $1,285, about 9 per cent above the average of $1,175 per capita spent in the other nine provinces. The higher rate of increase in Ontario compared to other provinces has resulted in Ontario's rank in per capita health spending increasing from fifth highest in 1983-84 to third highest in 1987-88.

**PROVINCIAL HEALTH CARE SPENDING [1] PER CAPITA**
**1983-84 TO 1987-88**




**1 Combined Provincial and Local government sectors.**
**2 Ontario's rank among provinces, from highest to lowest.**
Source: Statistics Canada

## Transfer Payments

Almost three-quarters of the Government's expenditures, or $27.8 billion, are transfer payments to third parties such as hospitals, school boards, universities and municipalities. The principal components of these transfers are listed below.

| 1988-89 Transfer Payments | | Table 5 |
|---|---|---|
| | $ Billion | % of Spending |
| Five Major Transfers | | |
| Hospitals | 5.5 | 14.5 |
| Colleges | 0.7 | 1.7 |
| Universities | 1.6 | 4.1 |
| School Boards | 3.9 | 10.3 |
| Municipalities | 4.2 | 11.0 |
| Other Transfers | | |
| OHIP | 4.0 | 10.6 |
| ODB | 0.7 | 1.8 |
| Other | 7.3 | 19.4 |
| Total Transfer Payments | 27.8 | 73.4 |

Note: May not add due to rounding.
Source: Ontario Ministry of Treasury and Economics.

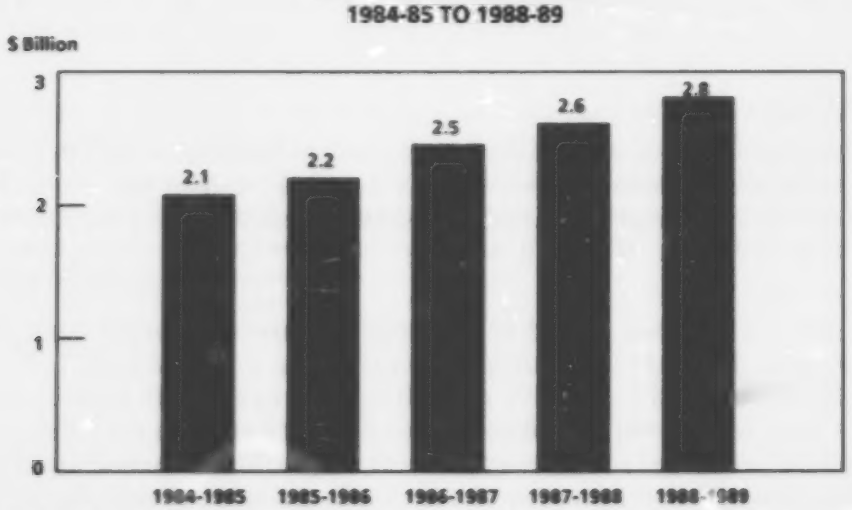
## Non-Transfer Payment Expenditures

The 26.6 per cent of expenditures which are not in the form of transfer payments amount to $10.1 billion. More than $4.0 billion of non-transfer payments will be spent on public debt interest. The remaining $6.1 billion will fund institutions operated by the Province, such as psychiatric hospitals and correctional facilities, and other government programs, including administration.

## Capital

In total, approximately $2.8 billion is provided in 1988-89 for capital investments, including investments made by transfer payment recipients. Since 1984-85, Provincial capital expenditures have increased at an average annual rate of 6.6 per cent. The graph below shows the level of capital expenditures in recent years.

CAPITAL EXPENDITURES
1984-85 TO 1988-89




Source: Ontario Ministry of Treasury and Economics.

## Spending Control

### Savings and Constraints Measures

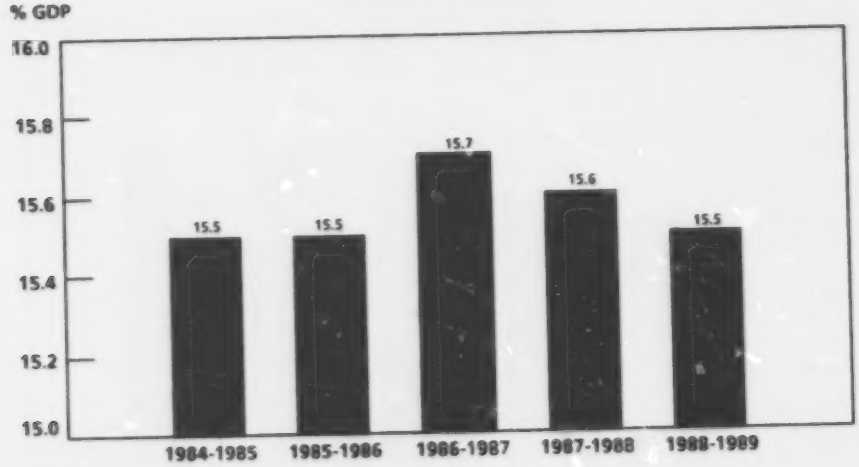
The 1988-89 Budget contained a provision for a Government-wide $500 million expenditure savings and constraints program. This measure was part of the Government's continuing efforts to control spending and improve the efficiency of program delivery. In the 1987-88 fiscal year, $350 million in savings were achieved in this way.

This year, every Ministry contributed to the savings and constraints goal through across-the-board reductions in total salaries and benefits of two per cent and reductions in non-payroll expenditures of six per cent. In addition, some ministry-specific reductions were applied to general program areas based on reduced cash flow requirements.

### Expenditure Growth

In each of the past two years, the Province's growth in expenditures has been held below the rate of growth in the economy. In 1987-88, expenditures grew at 8.6 per cent compared to a 9.7 per cent increase in nominal GDP. In 1988-89, expenditure growth is forecast at 8.4 per cent compared to 9.2 per cent growth forecast for nominal GDP. These trends have resulted in a decline in expenditures as a share of Gross Domestic Product.

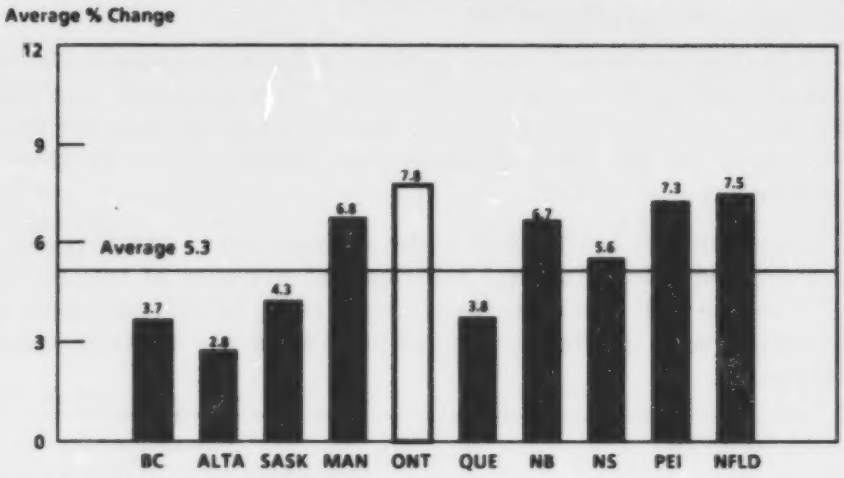
EXPENDITURE AS A SHARE OF THE ECONOMY
1984-85 to 1988-89




Source: Ontario Ministry of Treasury and Economics.

Relative to other provinces, Ontario has had the highest rate of growth in per capita expenditures over the past four years. From 1985-86 to 1988-89, the all-province average annual rate of per capita expenditure growth has been 5.3 per cent, compared to Ontario's average rate of 7.8 per cent.

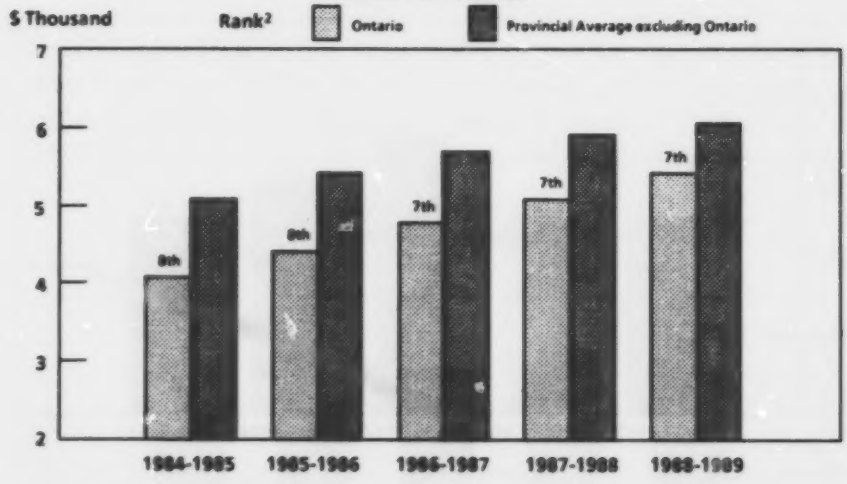
**PER CAPITA SPENDING GROWTH**
**1985-86 TO 1988-89**




Source: Ontario Ministry of Treasury and Economics.

Despite high rates of expenditure growth, the level of total per capita expenditures in Ontario remains below the average level of other provinces, ranking Ontario 7th among the provinces in per capita spending. Faster expenditure growth in Ontario is narrowing this spending gap, however. This trend is shown in the following chart.

**TOTAL PROVINCIAL EXPENDITURES[1] PER CAPITA**
**1984-85 TO 1988-89**




[1] Combined Provincial and Local government sectors.

[2] Ontario's rank among provinces, from highest to lowest.

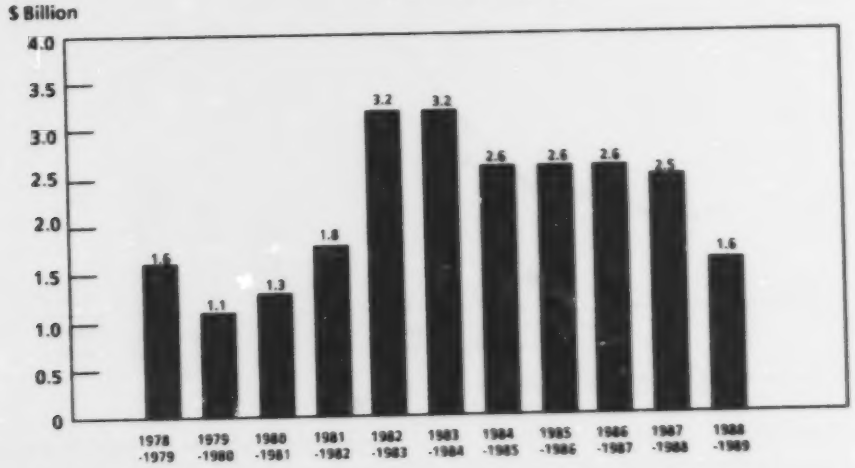
Source: Ontario Ministry of Treasury and Economics.

## Fiscal Indicators

Ontario's fiscal trends can be assessed in terms of commonly used indicators. The following section evaluates the fiscal position of the province.

Ontario's deficit rose to a level of more than $3.1 billion in 1982-83, but since that time has declined to $2.5 billion in 1987-88, and is forecast to be $1.6 billion in 1988-89, a reduction of almost $900 million from the previous year.

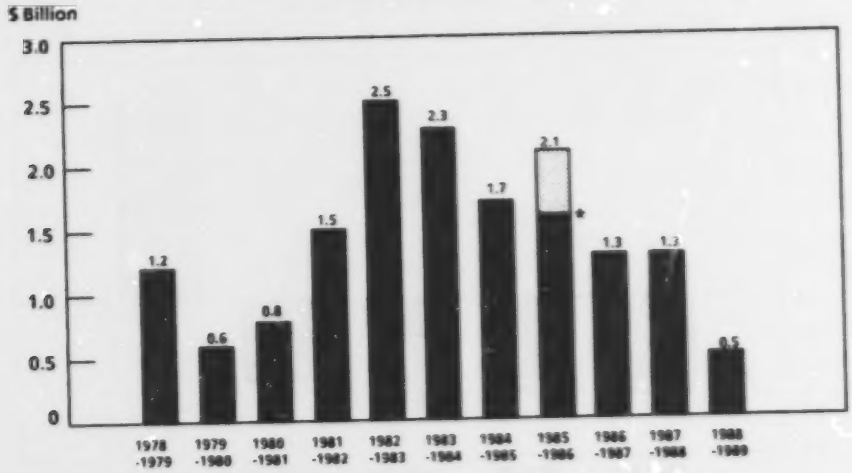
**ONTARIO DEFICIT**
**1978-79 TO 1988-89**




Source: Ontario Ministry of Treasury and Economics.

Net cash requirements have been reduced from the $2.5 billion peak level reached in 1982-83 to $1.3 billion in 1987-88, and are expected to decline to an estimated $482 million in 1988-89.

**ONTARIO NET CASH REQUIREMENTS**
**1978-79 TO 1988-89**

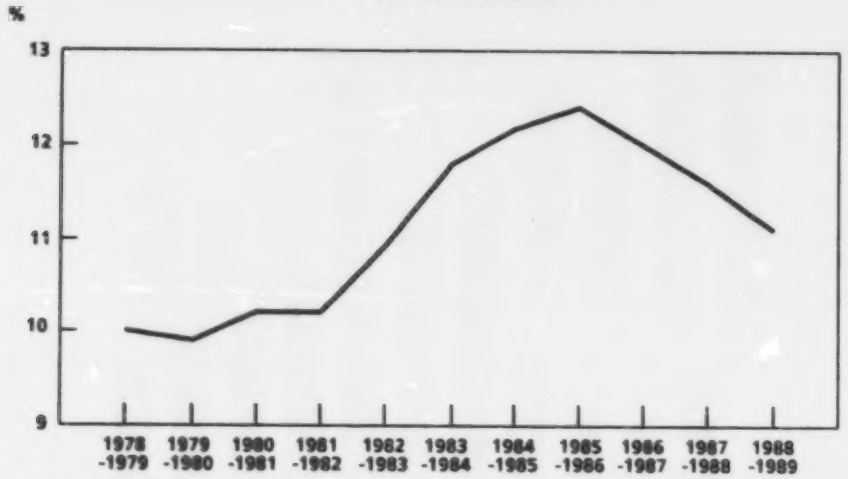



* Excludes extraordinary adjustments of $0.5 billion.

Source: Ontario Ministry of Treasury and Economics.

Ontario's public debt interest costs will exceed $4.0 billion in 1988-89, requiring 11.1 per cent of revenues. By contrast, federal public debt charges in 1988-89 are currently forecast at 31 per cent of federal budgetary revenues. The Ontario proportion continues its downward trend from a high of 12.4 per cent in 1985-86.

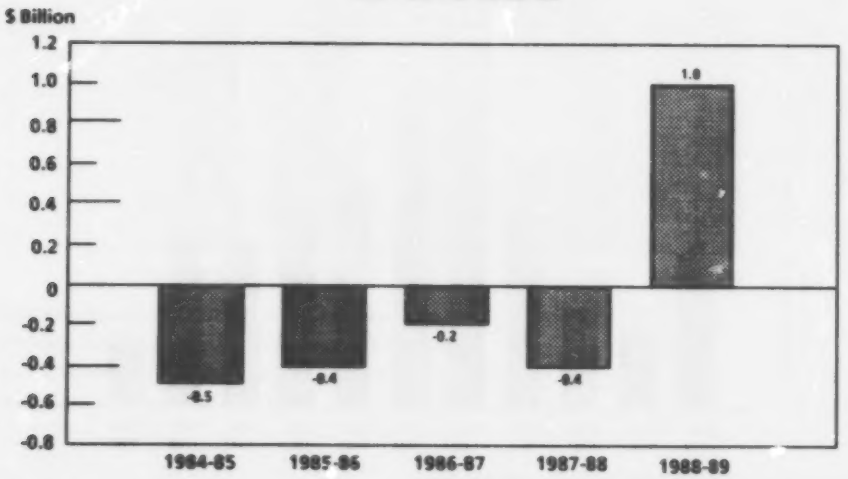
**PUBLIC DEBT INTEREST AS A PERCENTAGE OF REVENUE**
**1978-79 TO 1988-89**




Source: Ontario Ministry of Treasury and Economics.

Ontario's operating position reflects the Province's ability to pay for day-to-day operating needs from current revenues. Current expenditures exclude spending on capital investments, while current revenues exclude one-time cash flow increases associated with the federal government's acceleration of personal income tax transfers. In 1988-89, Ontario's operating position will be in a surplus of almost $1 billion. This surplus will contribute towards the funding of more than $2.8 billion in capital expenditures this year.

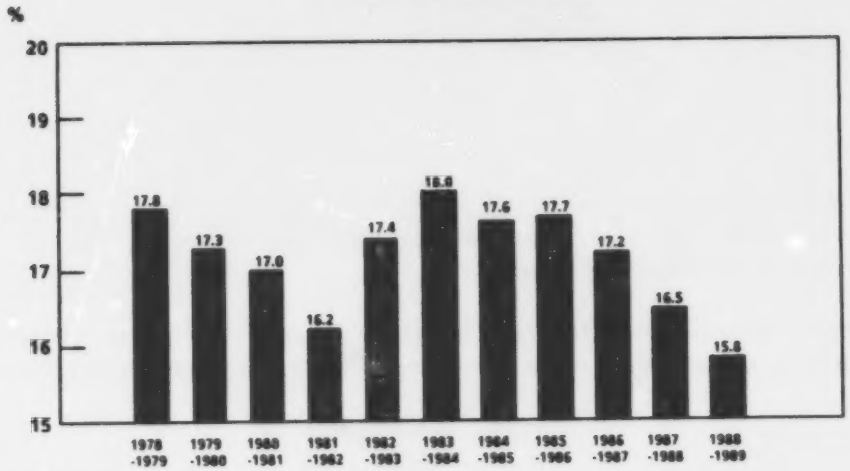
**ONTARIO OPERATING POSITION**
**1984-85 TO 1988-89**




Source: Ontario Ministry of Treasury and Economics.

Ontario's total accumulated own purpose debt is expected to be $38.8 billion by the end of 1988-89. Measured as a share of the economy, the debt burden has moderated in the past five years. From a peak of 18.0 per cent of provincial Gross Domestic Product in 1983-84, the debt declined to 16.5 per cent in 1987-88. In 1988-89, debt as a share of the economy is expected to decline further to 15.8 per cent, the lowest proportion achieved since 1974-75.

**TOTAL OWN-PURPOSE DEBT AS A SHARE OF THE ECONOMY**
**1978-79 TO 1988-89**

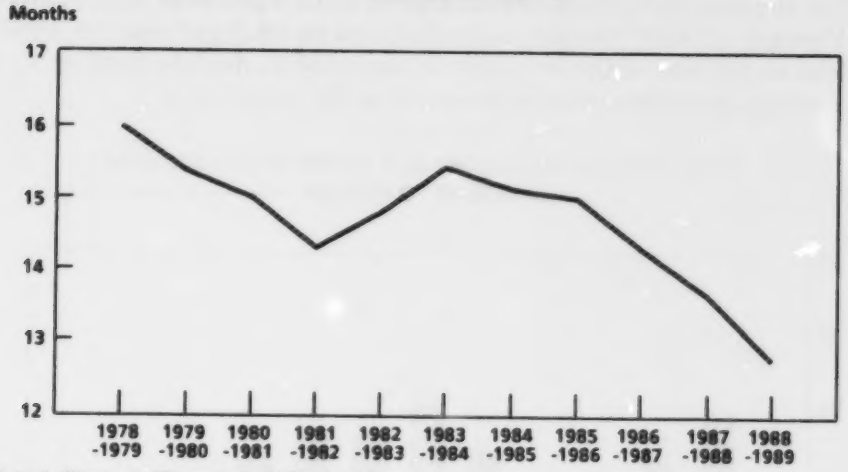



Source: Ontario Ministry of Treasury and Economics.

As of March 31, 1988, the Province has in addition accumulated $7.5 billion of debt on behalf of Ontario Hydro. The Province has also guaranteed $17.5 billion of Ontario Hydro's borrowing.

Another fiscal indicator used as a measure of Ontario's ability to carry its total own-purpose debt is the number of months of revenue that would be required to repay this debt. This number has fallen steadily in the past five years, from 15.4 months in 1983-84 to 13.7 months in 1987-88. In 1988-89, it is expected to fall further to 12.8 months, lower than in any other year since 1970-71.

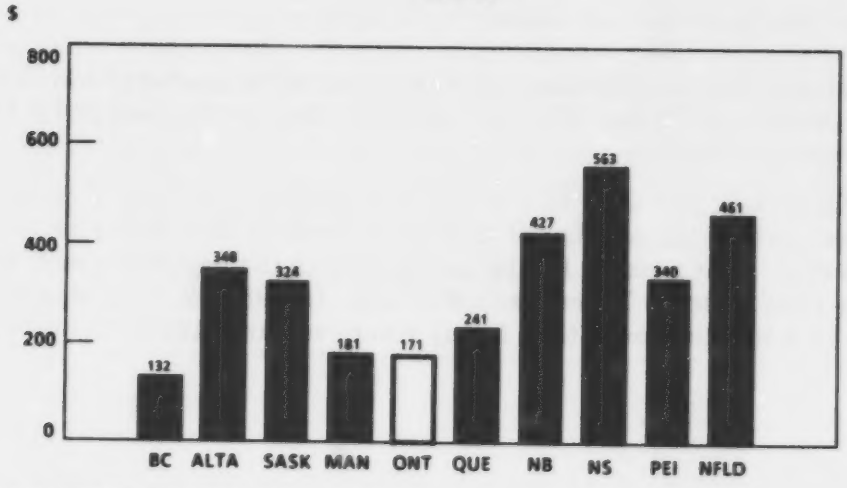
**MONTHS OF REVENUE TO REPAY TOTAL DEBT**
**1978-79 TO 1988-89**




Source: Ontario Ministry of Treasury and Economics.

On an interprovincial basis, Ontario's fiscal performance compares favourably. At $171 per person, Ontario will have the second lowest deficit per capita in 1988-89.

**DEFICITS PER CAPITA**
**1988-89**

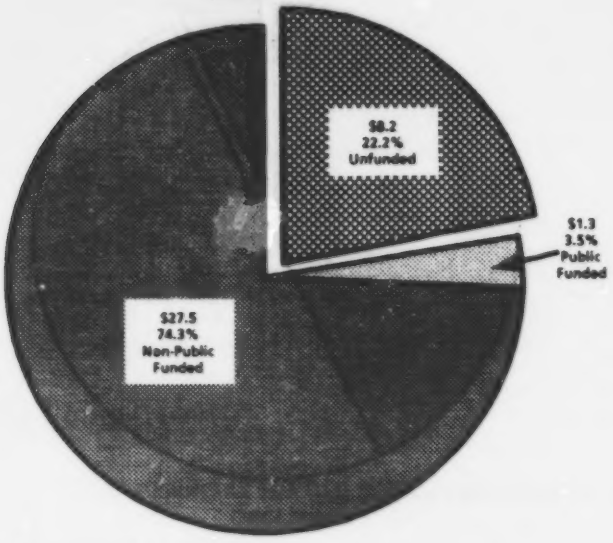



Source: Ontario Ministry of Treasury and Economics.

## Debt and Debt Financing*

### Ontario's Debt

COMPOSITION OF ONTARIO'S OWN-PURPOSE TOTAL DEBT
MARCH 31,1988
($BILLION)




Source: Ontario Ministry of Treasury and Economics.

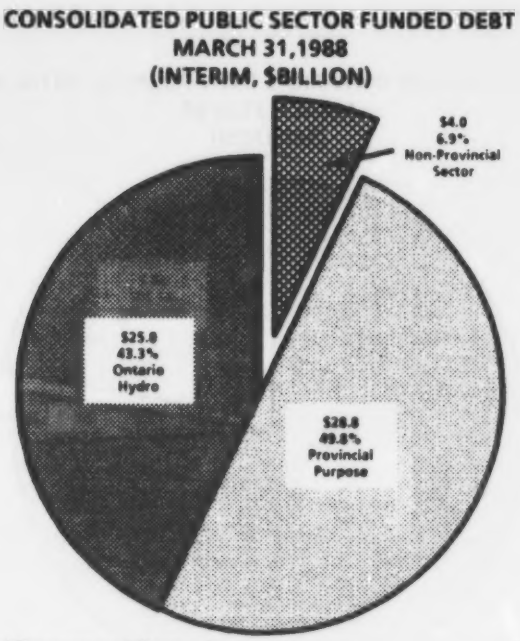
Ontario's own-purpose total debt consists of funded and unfunded debt. Own-purpose total debt amounted to $37 billion as of March 31, 1988.

Funded debt, the largest portion, has a specified term to maturity and is secured by a debt instrument such as a bond or Treasury Bill. Ontario's funded debt is concentrated in non-public debt, owed primarily to the Canada Pension Plan (CPP) and the Teachers' Superannuation Fund (TSF) in the form of long-term, non-marketable securities at market-related rates of interest. Debt owed to the general public constitutes 3.5 per cent of the Province's total debt. The Province's estimated funded debt at March 31, 1989 will be $29.6 billion of which about 90 per cent will be owed to the CPP and TSF.

Unfunded debt refers to obligations that are not secured by a debt instrument, such as deposits with the Province of Ontario Savings Office and for the Public Service Superannuation Fund (PSSF). Unfunded debt represents 22.2 per cent of Ontario's total debt, up from 16 per cent ten years ago. Ontario's own-purpose total debt will be about $39 billion by the end of fiscal 1988-89 compared to $18.1 billion ten years ago.

*All Ontario debt figures for 1988-89 are based on the September 30, 1988 Ontario Finances.

## Consolidated Public Sector Funded Debt



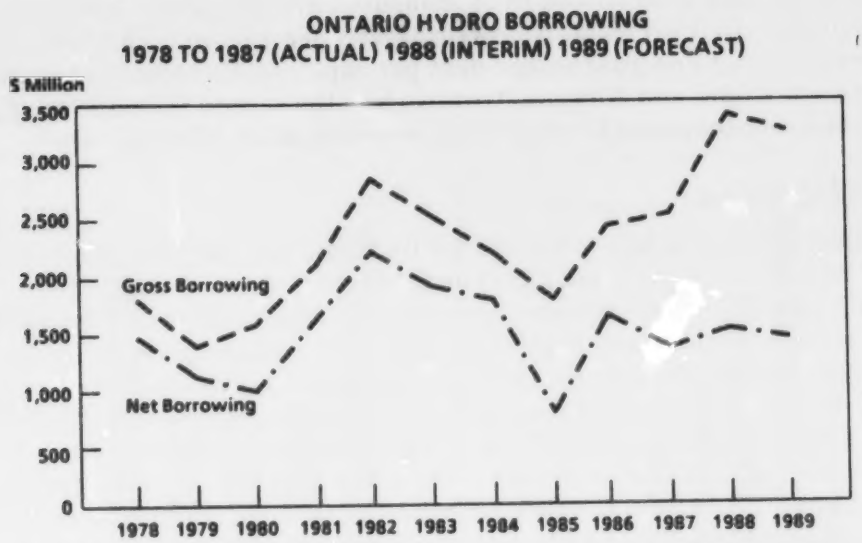

Source: Ontario Ministry of Treasury and Economics.

The broadest measure of funded debt in the Ontario Public Sector is Consolidated Public Sector Funded Debt, which includes debt incurred at all levels of Provincial jurisdiction. As of March 31, 1988, Consolidated Public Sector Funded Debt is estimated to have reached $57.8 billion.

The preponderance of Provincial and Provincially-guaranteed debt in this measure illustrates Ontario's practice of centralizing public sector financing at the Provincial level. Ontario's direct and guaranteed funded debt, which is over 90 per cent of the consolidated debt, consists of obligations for the Province's own purpose or for Ontario Hydro. Due to Ontario's practice of centralized financing, there is a limited requirement for public borrowing by local bodies, colleges and hospitals. Internal funds and Provincial grants finance a large proportion of local capital expenditures, with the remainder financed by borrowing. Local government debt is about 4 per cent of consolidated funded debt while less than one-half of one per cent consists of the obligations of universities, colleges and hospitals. The Provincial (direct and guaranteed) share of Consolidated Public Sector Funded Debt has been rising over time, reflecting the centralized approach to financing.

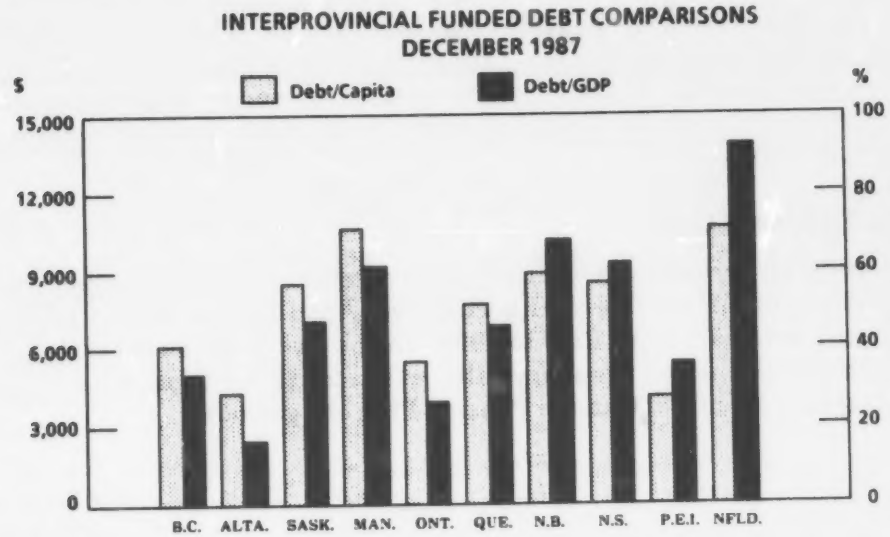
## Hydro Borrowing

In 1988 and 1989, Ontario Hydro's annual gross borrowing is expected to be around $3.4 and $3.2 billion, respectively, with borrowing net of retirements amounting to $1.5 billion in 1988 and $1.5 billion in 1989. The Province will continue to monitor Hydro's financing needs and plans to ensure that they are consistent with the Province's fiscal and financing plans.




Source: Ontario Hydro.

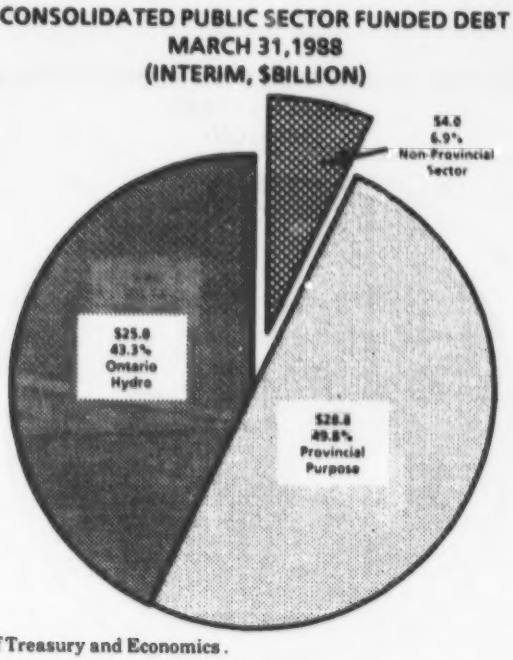
## Interprovincial Debt Comparison




Source: Bank of Canada Review and Ontario Ministry of Treasury and Economics.

Interjurisdictional debt comparisons usually focus on funded debt measures because this assures a standard of conceptual uniformity and comparability across jurisdictions and over time. Similarly, in order to avoid the inconsistencies caused by provinces assuming different types of debt at different levels of the public sector, the sum of funded debt owed by a province and debt guaranteed by a province is often used in interprovincial comparisons. Nevertheless, the comparisons remain limited by differences in treatment across provinces of sinking funds and purchases by public sector investment funds, such as the Alberta Heritage Savings Trust Fund.

## Consolidated Public Sector Funded Debt




Source: Ontario Ministry of Treasury and Economics.

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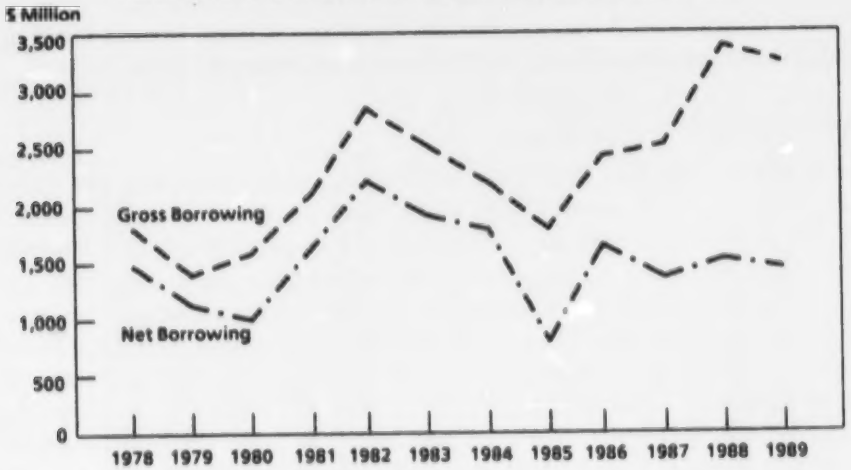
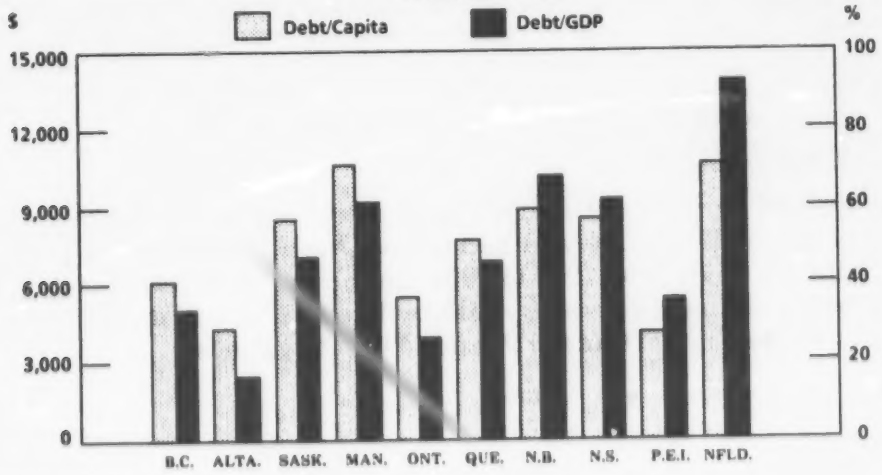
ONTARIO HYDRO BORROWING
1978 TO 1987 (ACTUAL) 1988 (INTERIM) 1989 (FORECAST)




Source: Ontario Hydro.

## Interprovincial Debt Comparison

INTERPROVINCIAL FUNDED DEBT COMPARISONS
DECEMBER 1987




Source: Bank of Canada Review and Ontario Ministry of Treasury and Economics.

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Ontario's direct and guaranteed debt measures are relatively low compared to other provinces. In 1987, Ontario owed $5,458 per person. This was the third lowest level of direct and guaranteed debt per capita in Canada, higher only than Prince Edward Island and Alberta. Ontario had the second lowest level of debt as a per cent of Gross Domestic Product (26.5 per cent), after Alberta.

## Ontario's Financing

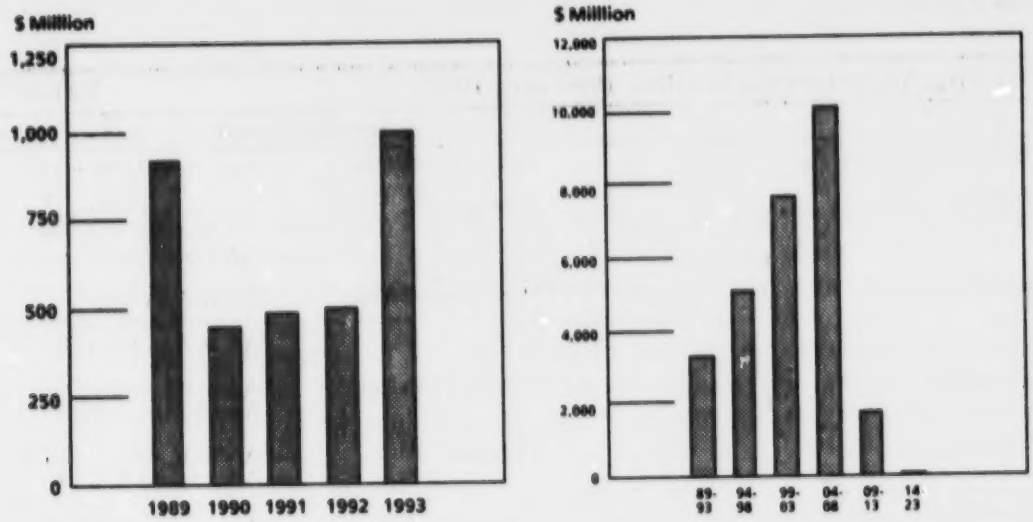
The Province of Ontario has available for its financing purposes the funds of the Teachers' Superannuation Fund (TSF) and Ontario's share of the Canada Pension Plan (CPP), as well as domestic and international capital markets. Because of the structure of contributions and benefits of these two pension plans, they have been a growing source of financing for Ontario. In 1988-89, availability of non-public sources of funds exceeds the Province's needs and, consequently, Ontario will decline the CPP funds available to it. CPP funds not required by the Province have been offered to Ontario Hydro. To date, in 1988-89, the Province has borrowed $523 million from the CPP on behalf of Ontario Hydro. In addition, the 1988 Budget announced that $2 billion of CPP funds would be made available to aid in the provision of 30,000 units of non-profit housing over the next 3-5 years.

Recent reports to the government from Lawrence Coward, on the financing of indexation benefits, from the Task Force on the Investment of Public Sector Pension Funds, and from Dr. David Slater, on consultations held with respect to these issues, have recommended that the investments of the TSF and PSSF be placed in marketable securities rather than non-marketable Provincial debentures and deposits. If these recommendations were accepted, the Province would increasingly meet its financing needs from public market sources, as do most other provinces.

## Ontario's Maturing Debt

Approximately 12 per cent of Ontario's funded debt (excluding Treasury Bills) is scheduled to mature in the five-year period from April 1988 to March 1993 and 30 per cent in the ten years from 1989 to 1998. In the five-year period ending March 1993, maturities (excluding Treasury Bills) will total $3.4 billion, with 70 per cent representing retirements of Canada Pension Plan obligations.

**ONTARIO DEBT MATURITY**




Source: Ontario Ministry of Treasury and Economics.

## Credit Worthiness

**Provincial Ratings**
**October 1988**

**Table 6**

| | Standard and Poor's (S&P) | Moody's | Canadian Bond Rating Service (CBRS) | Dominion Bond Rating Service (DBRS) |
|---|---|---|---|---|
| British Columbia | AA | Aa2 | AA | AA (low) |
| Alberta | AA+ | Aa1 | AA | AA |
| Saskatchewan | AA- | A1 | AA- | A (high) |
| Manitoba | A+ | A1 | AA- | A (low) |
| Ontario | AAA | Aaa | AAA | AA |
| Quebec | AA- | Aa3 | A | A (high) |
| New Brunswick | A+ | A1 | A | A |
| Nova Scotia | A- | A2 | A- | A (low) |
| Prince Edward Island | NR* | A3 | BBB+ | A (low) |
| Newfoundland | A- | Baa1 | BBB | BBB |

* Not Rated.

Source: Ontario Ministry of Treasury and Economics, Canadian Bond Rating Service, Dominion Bond Rating Service, Moody's Bond Survey and Standard and Poor's CreditWeek.

Following the economic recession of the early 1980's, nearly all Canadian provinces were downgraded by one or more major credit rating agencies, including Standard and Poor's downgrading of Ontario in November 1985. In the past two years, four western provinces were downgraded and three eastern provinces were upgraded, reflecting the unevenness of economic recovery across Canada. In August 1988, Standard and Poor's restored Ontario's rating to AAA, making

**Ontario the only Canadian province assigned Triple A by three credit rating agencies (Standard and Poor's, Moody's and the Canadian Bond Rating Service). The Province shares Dominion Bond Rating Service's highest provincial rating with Alberta (AA).**

**Rating Adjustments in 1986, 1987 and 1988** **Table 7**

| | | Rating Change |
|---|---|---|
| British Columbia | Downgraded from: | Aa1 to Aa2 (Moody's) |
| Alberta | Downgraded from: | Aaa to Aa1 (Moody's)<br>AAA to AA+ (S&P)<br>AAA to AA (CBRS) |
| Saskatchewan | Downgraded from: | AA to AA- (S&P)<br>Aa3 to A1 (Moody's)<br>AA to AA- (CBRS) |
| Manitoba | Downgraded from: | AA- to A+ (S&P)<br>A to A(low) (DBRS) |
| Ontario | Upgraded from: | AAA- to AAA (CBRS)<br>AA+ to AAA (S&P) |
| Quebec | Upgraded from: | A1 to Aa3 (Moody's) |
| New Brunswick | Upgraded from: | A2 to A1 (Moody's) |

Source: Ontario Ministry of Treasury and Economics, Canadian Bond Rating Service, Moody's Bond Survey and Standard and Poor's CreditWeek.

## Federal-Provincial Funding Programs

The following sections describe the two major programs through which the provinces now receive substantial federal funding: the fiscal arrangements and the Canada Assistance Plan. In addition, the proposed Canada Child Care Act and some implications for Ontario are highlighted.

### Federal-Provincial Fiscal Arrangements

*Introduction*

The federal-provincial fiscal arrangements are the institutional vehicles through which the federal government transfers funds to the provinces as part of its historical commitment to certain national shared-cost programs, and to the principle of interprovincial fiscal capacity equalization. The largest of these payments is made in respect of health care and post-secondary education under Established Programs Financing. Funds are also transferred under the Equalization program, the Fiscal Stabilization program, and the Personal Income Tax Revenue Guarantee.

Although often discussed in terms of federal-provincial negotiation and agreement, the fiscal arrangements are under the sole legislative and administrative control of the federal government. Every five years, legislation in this area is drafted and enacted by the federal government, and requires no provincial enabling legislation, support or even agreement to operate. In practice, however, Ottawa has consulted with the provinces on potential revisions to the legislation prior to enactment.

*Established Programs Financing*

Adopted in 1977 to replace the federal-provincial shared-cost programs in the fields of health and post-secondary education, Established Programs Financing was regarded as a milestone in co-operative federalism in Canada. The essence of the new arrangement was that the provinces, long dissatisfied with the cumbersome and inflexible nature of the cost-sharing arrangements, were given greater policy and administrative latitude through a move to block funding. At the same time, Ottawa lessened its financial risk by tying its contributions to the rate of growth of the national economy rather than to provincial expenditures.

Shortly after the new arrangement had been agreed upon, the federal government decided to keep track of the individual cash components of the transfers for health and post-secondary education. While not consistent with the principle of block funding, the split was for federal bookkeeping purposes only and did not require provinces to demonstrate that they had, in fact, spent the funds in these areas.

The Canada Health Act passed by Parliament in 1984, sets program criteria and conditions of payment for the cash portion of transfers paid to the provinces for insured health care services and extended health care. Under the terms of the legislation, each province's health insurance plan must satisfy federal requirements respecting comprehensiveness, portability, universality, accessibility and public administration.

The federal government is empowered to withhold a portion of the provincial transfer payments equal to the amount that physicians bill above the rates set out

in the provincial fee schedules. Dollar for dollar deductions are also imposed on provinces that permit user charges. Between July 1984 and June 1986, over $106 million in payments to Ontario were withheld by the federal government. The Province has since complied with the conditions of the Canada Health Act by eliminating extra-billing for insured health services and has recouped the amount withheld.

As shown in Table 8, the federal government has taken a number of further actions to restrain the growth of its payments to the provinces. When the fiscal arrangements were amended in 1982, the Revenue Guarantee Compensation, which was built into Established Programs Financing as part of the 1977 agreement, was removed. This effectively eliminated a portion of the per capita entitlements.

Established Programs Financing transfer growth is based on both growth in the economy and population increases for individual provinces. Under the two-year federal "6 & 5" restraint program introduced in June 1982, per capita limits were imposed on post-secondary education transfer growth.

Most recently, the federal government's Bill C-96, An Act to Amend the Federal-Provincial Fiscal Arrangements and Federal Post-Secondary Education and Health Contributions Act, 1977, received Royal Assent in June 1986. It reduces the annual growth in per capita Established Programs Financing transfers by two percentage points. In 1988-89, Bill C-96 will reduce Ontario's Established Programs Financing entitlements by $395 million. Taken together, the reductions in Established Programs Financing entitlements for Ontario amount to $976 million in 1988-89, and will exceed $1 billion in 1989-90.

**Provincial Losses Due To Federal EPF* Cuts Since 1982** — **Table 8**

($ Million)

| | Elimination of Revenue Guarantee Compensation | | "6 & 5" Caps on PSE** Transfers | | Reduction of EPF* Escalator | | Total |
|---|---|---|---|---|---|---|---|
| | Ontario | All Prov.*** | Ontario | All Prov.*** | Ontario | All Prov.*** | Ontario |
| 1982-83 | 293 | 827 | - | - | - | - | 293 |
| 1983-84 | 323 | 910 | 41 | 117 | - | - | 364 |
| 1984-85 | 354 | 992 | 90 | 253 | - | - | 444 |
| 1985-86 | 382 | 1,068 | 98 | 273 | - | - | 480 |
| 1986-87 | 409 | 1,139 | 105 | 291 | 114 | 316 | 628 |
| 1987-88 | 436 | 1,205 | 111 | 308 | 246 | 679 | 793 |
| 1988-89**** | 463 | 1,272 | 118 | 325 | 395 | 1,088 | 976 |
| 1989-90**** | 494 | 1,345 | 126 | 344 | 568 | 1,549 | 1,188 |
| TOTAL | 3,154 | 8,760 | 690 | 1,911 | 1,323 | 3,632 | 5,167 |

* Established Programs Financing.
** Post-Secondary Education.
*** Includes Territories.
**** Forecast
Note: Figures may not add due to rounding.
Source: Ontario Ministry of Treasury and Economics

Source: Department of Finance, Canada and Ontario Ministry of Treasury and Economics.

Federal support for Ontario health and post-secondary education programs has fallen from a peak of 52 per cent of provincial-local spending for these purposes in 1979-80 to under 40 per cent in 1988-89.

*Equalization*

Equalization payments are unconditional transfers from the federal government to qualifying provinces, with the purpose, as enshrined in Section 36 of the Constitution Act, 1982, of ensuring that provincial governments have sufficient revenues to provide "reasonably comparable levels of public services at reasonably comparable levels of taxation". The actual determination of equalization entitlements has evolved over the years by refinements and adjustments to the formula since the inception of the program in 1957. Although there have been disagreements about these changes, some of which have had quite dramatic effects, all provinces have supported the overall thrust of the Fiscal Equalization Program.

Ontario has never been an equalization recipient. Indeed, when oil price shocks created the possibility of Ontario receiving equalization payments, these equalization payments were prevented through a retroactive legislative amendment in 1981.

The current "five-province standard" of fiscal capacity replaced a national average standard in 1982. This change, combined with a number of tax base modifications, tended to disadvantage Quebec and Manitoba. Accordingly, a transitional guarantee was incorporated into the formula. The transitional guarantee provided that no province could receive less under the new formula than it received in the last year of the old formula. Provision was made for a specified amount of growth.

As Table 9 illustrates, all provinces except Alberta, British Columbia and Ontario receive significant federal equalization transfers.

**Estimated Equalization Entitlements by Province, 1988-89** — **Table 9**

| | ($ Million) | ($ Per Capita) |
|---|---|---|
| Newfoundland | 844 | 1,486 |
| Prince Edward Island | 172 | 1,340 |
| Nova Scotia | 783 | 886 |
| New Brunswick | 776 | 1,087 |
| Quebec | 3,299 | 497 |
| Manitoba | 635 | 586 |
| Saskatchewan | 288 | 285 |
| TOTAL | 6,798 | 616 |

Notes: 1 Figures may not add due to rounding.
2 Ontario, Alberta and British Columbia have net negative entitlements and do not receive equalization payments.

Source: Department of Finance, Canada: Provincial Fiscal Equalization, Second Estimate, 1988-89 (September, 1988).

For 1988-89, the current estimate of total equalization entitlements is $6.8 billion. The sole legislative constraint on the growth of equalization entitlements is that aggregate transfers must not exceed the year over year increase in Gross National

Product (GNP). So far, this ceiling has not had to be applied. Although Quebec receives the greatest share of total equalization, on a per capita basis, it receives the second least.

*Fiscal Stabilization*

In order to protect provinces from sudden year-over-year losses in revenue resulting from an economic downturn, the federal government has provided for fiscal stabilization payments. These unconditional cash transfers ensure that each province's tax revenues, measured on the basis of constant tax rates and structure, plus its equalization payments, will not be less than they were in the previous year.

In 1987-88, the federal government introduced, among other technical changes, an annual ceiling of $60 per capita for grant assistance. Fiscal Stabilization entitlements exceeding this limit are provided as interest-free loans repayable within five years. To date, only one province has received payments under this program -- British Columbia received $175 million in respect of the 1982-83 fiscal year. However, fiscal stabilization payments provide an important guarantee for many provinces.

*Personal Income Tax Revenue Guarantee*

Since provinces set personal income tax rates in relation to the basic federal tax, the federal Personal Income Tax Revenue Guarantee provides limited compensation to provinces when federal tax policy changes reduce provincial revenues within a taxation year. Compensation is provided for the amount that personal income tax revenue losses exceed 1.0 per cent of basic federal tax for the province. The only Revenue Guarantee payment made to date has been $4.3 million to Saskatchewan in respect of the 1985 taxation year.

## Canada Assistance Plan

The Canada Assistance Plan (CAP) was established by federal legislation in 1966 as a cost-sharing mechanism for provincially-administered social assistance and welfare programs. The Canada Assistance Plan replaced the targetted shared-cost programs that provided assistance for the elderly, the blind, the disabled and the unemployed. By the end of the 1960s, these programs had come under increasing criticism for their eligibility restrictions. The new program was designed to bring a measure of order and coherence to fragmented provincial public assistance systems.

Since its inception, federal payments under CAP increased from $0.3 billion in 1967-68 to an estimated $5.0 billion in 1988-89. This makes CAP the third largest source of transfers to the provinces after Established Programs Financing and equalization. Ontario revenue from CAP is expected to total $1.3 billion for 1988-89.

The Canada Assistance Plan is intended to act as a safety net. Under its provisions, the federal government contributes an amount equal to 50 per cent of provincial expenditures on assistance payments (food, shelter and clothing) to individuals in need, and a range of services, including child welfare, child care, homemaker services for the elderly, institutions for the disabled and family counselling. To qualify for federal CAP funds, provincial programs must be

designed to benefit those "in need or likely to become in need". As well, potential beneficiaries must demonstrate their eligibility through either a needs test or an income test, as determined by each province and subject to federal guidelines.

The Canada Assistance Plan has been the subject of numerous reviews during the last two decades. In 1970-71, the Senate Committee on Poverty issued a report that was critical of CAP and recommended that it be replaced by a guaranteed annual income. Ten years later, negotiations were underway to remove social services from CAP and provide them through a block fund under a proposed Social Services Financing Act modelled on Established Programs Financing. The proposal, however, was withdrawn when the provinces refused to accept a reduction in the Established Programs Financing escalator to GNP growth less one per cent. The proposal to replace the federal share of CAP and other federal tax and transfer programs, such as family allowances and child tax credits, with a guaranteed annual income, was resurrected by the Macdonald Commission in 1985 when it recommended the adoption of a Universal Income Security Program.

More recently, the Nielsen Task Force on Program Review found no support for a major revision of CAP. However, its report did register concern over the trend toward long-term dependence on assistance among "employables" and warned of the danger that future CAP costs may become unaffordable as a result. The Nielsen review concluded that it may be necessary to change the open-ended nature of CAP funding by limiting federal spending under the agreement. However, the Canada Assistance Plan remains a singular example of intergovernmental collaboration and cost-sharing of major social programs available across Canada.

## Canada Child Care Act

Provincial child care expenditures for this fiscal year are estimated at $300 million, an increase of 238 per cent from the level of 1984-85.

On September 26, 1988, the House of Commons passed the proposed Canada Child Care Act, draft legislation to enable the federal government to enter into cost-sharing agreements to contribute to provincial child care programs. The Act died during Senate review with the September 30 dissolution of Parliament, and would have to be re-introduced. In all, the federal government has announced a total of $6.4 billion for child care over seven years. Of this amount, $2.3 billion is for tax provisions, $60 million is for special programs for native people, $100 million is for special demonstration and research projects, and $3.9 billion is for contributions to provincial child care programs.

The federal government has offered to replace open-ended contributions to Ontario child care programs with a maximum $1.7 billion in federal program contributions over the 1988 to 1995 period. Subject to annual federal funding limits, Ottawa's contributions would include 75 per cent reimbursements for capital grants for approved not-for-profit child care facilities, as well as 50 per cent reimbursements for operating grants for all approved child care centres.

Provinces also have the option to continue current federal cost-sharing of child care expenditures under the Canada Assistance Plan rather than convert to an arrangement under the proposed Canada Child Care Act.

## Provincial-Local Transfers

In 1988-89, the Province will provide close to $4.2 billion in financial support to municipalities and municipal agencies, as indicated in Table 10.

Provincial support to school boards also amounts to almost $4.2 billion, including nearly $238 million in capital assistance.

**Highlights of Provincial Transfers to Local Governments**
($ Million)

**Table 10**

| | Outlook 1988-89 |
|---|---|
| Transfers to Municipalities | |
| Unconditional | 874 |
| Roads | 685 |
| Transit | 340 |
| Social Services | 1,367 |
| Health | 196 |
| Environmental | 142 |
| Recreational & Cultural | 90 |
| Other | 470 |
| Total Municipal Transfers | 4,164 |
| Transfers to School Boards | |
| General Legislative Grants | 3,915 |
| Capital Grants | 238 |
| Total School Transfers | 4,153 |
| Total Transfers to Local Government | 8,317 |

Source: Ontario Ministry of Treasury and Economics.

### Transfers to Municipalities

Transfer payments to municipalities are estimated to increase by 7.7 per cent in 1988-89.

The average annual growth in Provincial support to the municipal sector has significantly outpaced inflation in Ontario over the last five years. As Table 11 indicates, total operating transfers increased faster than the rate of inflation (4.6 per cent) while the growth in capital transfers kept pace with inflation, reflecting the more stable pattern of Provincial capital activity in general.

**Provincial Transfers to Municipalities** **Table 11**
($ Million)

| | 1983-84 | Outlook 1988-89 | Average Annual Increase (%) |
|---|---|---|---|
| Unconditional | 691 | 874 | 4.8 |
| Conditional | 1,305 | 2,181 | 10.8 |
| Total Operating | 1,996 | 3,055 | 8.9 |
| Capital | 899 | 1,109 | 4.3 |
| Total Transfers | 2,895 | 4,164 | 7.5 |

Source: Ontario Ministry of Treasury and Economics.

*Municipal Sector Performance*

Municipal spending in 1988 is expected to grow by 11.8 per cent. This growth continues to be led by the areas served by regional governments, excluding Metro Toronto, which account for 40 per cent of municipal spending. These areas are generally experiencing above-average service growth as measured by the growth in households. It should also be noted that individual municipal patterns of growth within these areas can vary considerably. By comparison, Table 12 shows that, for municipalities not within regional governments, spending growth is expected to average only 8.3 per cent.

**Estimated Municipal Spending, 1987 & 1988** **Table 12**
($ Million)

| | 1987 | 1988 | Increase (%) |
|---|---|---|---|
| Metropolitan Toronto | 3,643 | 4,060 | 11.4 |
| Other Regional Governments | 4,517 | 5,180 | 14.7 |
| **All Regional Governments** | **8,160** | **9,240** | **13.2** |
| Cities Not Part of Regional Governments | 1,595 | 1,726 | 8.2 |
| All Other Municipalities | 1,701 | 1,845 | 8.5 |
| **Non-Regional Governments** | **3,296** | **3,571** | **8.3** |
| **Total Municipal Sector** | **11,456** | **12,811** | **11.8** |

Source: Ontario Ministry of Municipal Affairs.

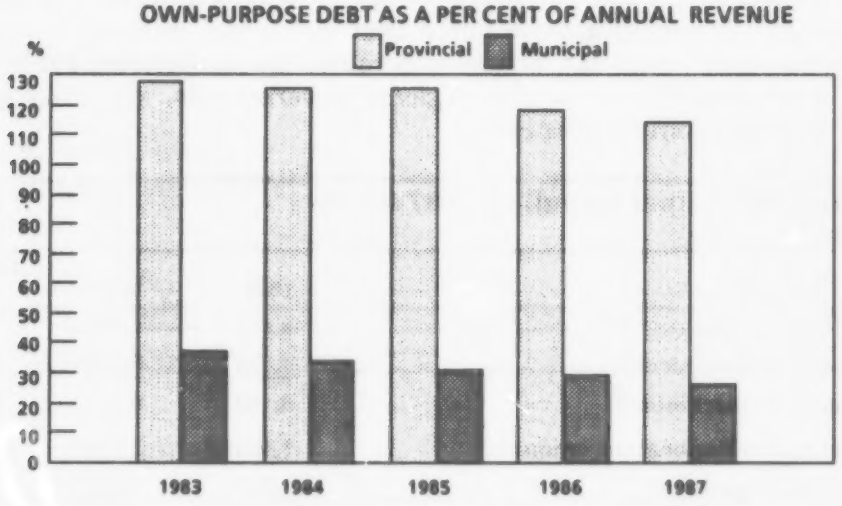
As shown in Table 13, the proportion of municipal financing accounted for by transfers and municipal property taxes has dropped over the period, with the difference being made up by other revenues, particularly user fees.

**Municipal Revenue Mix** (Per Cent) — **Table 13**

| | 1983 | 1988 |
|---|---|---|
| Property Taxation | 35.6 | 35.0 |
| Provincial Grants | 32.9 | 30.7 |
| All Other Revenues | 31.5 | 34.3 |
| | 100.0 | 100.0 |

Source: Ontario Ministry of Municipal Affairs.

As a group, municipalities are in a better position than the Province with respect to their debt burdens. "Debt" includes total long term debt and sewer and water project debt. In 1987, total municipal own-purpose debt was approximately $3 billion, or about 26 per cent of total annual revenues. By comparison, total Provincial own-purpose debt was 114 per cent of annual budgetary revenue. Public debt interest payments are estimated at about 11 per cent of annual revenues for the Province in 1988 -- higher than the 7 per cent estimated for municipalities.




Sources: Ontario Ministry of Treasury and Economics and Ontario Ministry of Municipal Affairs.

During the last five years, municipalities have, as a group, reduced their reliance on long-term borrowing to finance expenditures. It should be noted there are restrictions on the ability of municipalities to carry an operating deficit. The Ontario Municipal Board provides guidelines for measuring a municipality's ability to take on increased debt. As a general rule, the Board and the Ministry of Municipal Affairs have determined that a municipality should not commit to spend more than 20 per cent of its annual operating revenue on debt servicing. Municipalities retain a significant capacity to assume debt for capital projects or other major requirements. Table 14 below shows the most recent estimates of

municipal capacity to borrow funds, excluding debt assumed on behalf of school boards and Provincially-guaranteed debt.

**Estimated Municipal Debt Capacity, 1987** **Table 14**
($ Million)

| | Total Debt Capacity | Available Debt Capacity | |
|---|---|---|---|
| | | $ | % |
| Municipalities within Metropolitan Toronto | 3,449 | 2,847 | 82.5 |
| Municipalities within Regions | 3,317 | 2,454 | 74.0 |
| **All Regional Governments** | **6,767** | **5,301** | **78.3** |
| Municipalities within Counties | 2,281 | 1,957 | 85.8 |
| Municipalities within Districts | 655 | 630 | 96.2 |
| **All Non-Regional Governments** | **2,936** | **2,587** | **88.1** |
| **Total Municipal Sector** | **9,702** | **7,888** | **81.3** |

Source: Ontario Ministry of Municipal Affairs.

*Education Finance*

The funding of elementary and secondary education in Ontario is shared between the Province and local school boards. The Provincial share is distributed to school boards through the General Legislative Grants and capital programs with the school board share being raised from local property taxes. School funding is a significant component of government spending at both levels, as shown in Table 15.

**Education Finance in Perspective** **Table 15**
(Per Cent)

| | 1988-89 |
|---|---|
| **Transfer Payments to School Boards** | |
| Relative to Total Local Transfers | 49.9 |
| Relative to Provincial Budgetary Expenditure | 11.0 |
| **School Finance in the Local Sector** | |
| School Board Operating Spending Relative to Total Local Operating Spending | 45.9 |
| Average Residential School Taxes Relative to Total Local Property Taxes* | 50.6 |

* On a per-household basis

Source: Ontario Ministry of Treasury and Economics.

# *APPENDICES*


I. **Tax Expenditures**

II. **Health Care Expenditure Profile**

III. **Fiscal Capacity and Tax Effort**

IV. **Glossary of Terms**

# APPENDIX I

## Tax Expenditures

**Personal Income Tax Expenditures**
**Estimates of Ontario Revenue Foregone**
**in the 1988 Taxation Year**
($ Million)

**Table 1**

| | Ontario Revenue Foregone |
|---|---|
| **Tax Expenditures Shared with the Federal Government** | |
| Deductions and Exemptions | |
| Registered Retirement Savings Plan Contributions | 352 |
| Registered Pension Contributions | 258 |
| $100,000 Lifetime Capital Gains Exemption | 191 |
| Capital Gains Exclusion | 106 |
| Carrying Charges | 85 |
| Union Dues | 59 |
| Child Care Expenses | 38 |
| Moving Expenses | 9 |
| Non-Refundable Tax Credits | |
| Basic Personal Credit | 2,833 |
| Married Credit (including Equivalent-to-Married) | 440 |
| Age Credit | 158 |
| Charitable Donations | 151 |
| Unemployment Insurance Premiums | 150 |
| Canada Pension Plan Contributions | 137 |
| Credit for Dependent Children | 80 |
| Pension Income Credit | 38 |
| Medical Expenses | 23 |
| Tuition Fees | 22 |
| Education Credit | 10 |
| Disability Credit | 6 |
| **Tax Expenditures Solely Within Ontario's Jurisdiction** | |
| Ontario Health Insurance Plan Premium Assistance | 770 |
| Ontario Tax Grants to Seniors | 471 |
| Ontario Tax Credits | 444 |
| Ontario Home Ownership Savings Plan Tax Credit | 30 |
| Ontario Tax Reduction | 40 |
| Ontario Political Contribution Tax Credit | 5 |

* **Although not directly part of the Personal Income Tax system, these tax expenditures provide benefits to individuals.**

Source: Ontario Ministry of Treasury and Economics.

**Corporate Tax Expenditures**
**Estimates of Ontario Revenue Foregone in 1988-89** **Table 2**
($ Million)

| | Ontario Revenue Foregone |
|---|---|
| Corporate Income Tax | |
| Small Business Deduction | 385 |
| Capital Cost Allowance vs. Accounting Depreciation | 290 |
| Capital Gains Exclusion | 180 |
| Reduced Rate for Specified Sectors | 88 |
| Research and Development Super Allowance | 32 |
| Exploration and Development Expenses | 20 |
| Manufacturing Current Cost Adjustment | 10 |
| Allowable Business Investment Losses | 1 |
| Small Business Development Corporations Program | 0.3 |
| Ontario Mineral Exploration Program | 0.2 |
| Resource Allowance* | 0 |
| Capital Tax | |
| Flat Capital Tax for Small Business | 94 |
| Farm Equipment Dealers: Capital Tax Reduction | 0.3 |
| Mining Profits Tax | |
| Three-Year Mining Profits Tax Exemption for New Mines | 5 |
| $500,000 Mining Profits Exemption | 3 |

* Commences January 1, 1989

Source: Ontario Ministry of Treasury and Economics.

**Retail Sales Tax Expenditures** **Table 3**
**Estimates of Ontario Revenue Foregone in 1988-89**
($ Million)

| | Ontario Revenue Foregone |
|---|---|
| Services | |
| Professional | 3,657 |
| Commercial | 2,011 |
| Personal | 1,682 |
| Transient Accommodation | 39 |
| Admission fees | 28 |
| Goods | |
| Energy (including motive fuels) | 1,687 |
| Basic Groceries | 1,102 |
| Production Machinery | 818 |
| Reading Materials | 154 |
| Prepared Foods | 120 |
| Soil and Water | 110 |
| Prescription Drugs | 101 |
| Children's Clothing | 65 |
| Aircraft | 52 |
| Footwear | 34 |
| Medical Equipment | 26 |
| Feminine Hygiene Products | 10 |
| Purchaser Specific - All goods and services tax exempt or tax rebated | |
| Farmers | 190 |
| Visitors to Ontario | 23 |
| Hospitals | 14 |
| Religious/Charitable | 10 |
| Disabled Persons | 7 |
| Fishermen | 1 |
| Fur-trappers | 1 |
| Museums/Galleries | 1 |
| Municipalities (fire trucks) | 1 |

Source: Ontario Ministry of Treasury and Economics.

# Personal Income Tax Expenditures
# 1988 Tax Rules

## Tax Expenditures Shared with the Federal Government

### Deductions and Exemptions

**Registered Retirement Savings Plan Contributions** - Contributions are deductible from income up to prescribed limits. The allowable contribution for each year is governed by the maximum limit for that year ($7,500 in 1988), the individual's income and the amount of any contributions to a registered pension plan.

**Registered Pension Contributions** - Employee contributions as required under the pension plan are deductible from income.

**$100,000 Lifetime Capital Gains Exemption** - Taxpayers are permitted a cumulative lifetime capital gains exemption of $100,000.

**Capital Gains Exclusion** - One third of capital gains are tax-exempt.

**Carrying Charges** - Individuals may deduct from income the interest cost on money borrowed to make investments, fees for investment counselling and other investment related expenses.

**Union Dues** - Annual dues for membership in qualifying organizations are deductible from income.

**Child Care Expenses** - Expenses paid for child care services that enable single parents or both spouses in a two-parent family to earn income or attend an educational or training program are deductible from income. The maximum deduction is $4,000 for each child under the age of 7 and $2,000 for each child age 7 and over.

**Moving Expenses** - Unreimbursed moving expenses may be deducted from income by those who move at least 40 kilometres closer to their new workplace.

### Non-Refundable Tax Credits*

**Basic Personal Credit** - A credit of $520 is available to every taxfiler.

**Married Credit (including Equivalent-to-Married)** - A credit of up to $434 is available to a taxfiler in respect of a dependent spouse, or if not married, in respect of an eligible dependent living with the taxfiler.

**Age Credit** - The age credit of $281 is available to all taxfilers age 65 and over.

**Charitable Donations** - A credit is available in respect of charitable donations and for gifts to Canada or a province, or for gifts of cultural property.

**Unemployment Insurance Premiums** - A credit of up to $60 is available for required premiums.

* The income tax return does not show any amounts for Provincial non-refundable income tax credits. The value of these credits in respect of individual Ontario tax payable has been estimated by multiplying each federal credit by Ontario's tax rate of 51 per cent.

**Canada Pension Plan Contributions** - A credit of up to $41 is available for required contributions.

**Credit for Dependent Children** - A credit of $33 may be claimed in respect of each dependent child under age 19, with the credit doubled for the third and subsequent children in the family.

**Pension Income Credit** - This provision allows individuals, mostly seniors, to claim a credit of up to $87 in respect of their eligible pension income.

**Medical Expenses** - A credit is available in respect of out-of-pocket medical and dental expenses in excess of 3 per cent of Net Income.

**Tuition Fees** - A student may claim a credit in respect of eligible tuition fees, with any unused credit portion transferable to a supporting taxpayer.

**Education Credit** - This credit is for full-time students and is based on the number of months of attendance, with any unused credit portion transferable to a supporting taxpayer.

**Disability Credit** - This credit of $281 is available to taxpayers who meet prescribed disability criteria.

<u>Tax Expenditures Solely Within Ontario's Jurisdiction</u>

**Ontario Health Insurance Plan Premium Assistance** - This program eliminates or reduces OHIP premiums for low-income families and specified groups in society.

**Ontario Tax Grants to Seniors** - Property tax grants of up to $600 and sales tax grants of $50 are available to those age 65 and over.

**Ontario Tax Credits** - This program provides refundable tax credits to low and moderate income people under age 65 to reduce their property and sales tax burden.

**Ontario Home Ownership Savings Plan Tax Credit** - This program provides refundable tax credits of up to $500 for individuals and $1,000 for families saving for the purchase of a first home.

**Ontario Tax Reduction** - This program eliminates or reduces Ontario Income Tax of up to $150 for low-income taxfilers.

**Ontario Political Contribution Tax Credit** - A tax credit of up to $750 is available to offset a portion of contributions made to registered provincial political parties.

## Corporate Tax Expenditures
## 1988 Tax Rules

### Corporate Income Tax

**Small Business Deduction** - Canadian-controlled private corporations that qualify for the federal small business deduction are eligible for a reduction of the Ontario corporate income tax rate to 10 per cent on the first $200,000 of eligible income.

**Capital Cost Allowance vs Accounting Depreciation** - The capital cost allowance system allows companies to expense capital assets for tax purposes at a rate that generally exceeds book or accounting depreciation.

**Capital Gains Exclusion** - One-third of most capital gains are taxable, and one-third of capital losses can be used to offset taxable capital gains.

**Reduced Rate for Specified Sectors** - A one per cent tax rate reduction is provided for income earned from manufacturing, processing, mining, logging, farming, and fishing.

**Research and Development Super Allowance** - This provides a deduction from income otherwise subject to tax equal to a percentage of current and capital expenditures on research and development incurred in Ontario.

**Exploration and Development Expenses** - All Canadian and Ontario exploration and development expenses associated with mining activities are fully deductible.

**Manufacturing Current Cost Adjustment** - This provides a direct deduction from income otherwise subject to tax equal to a percentage of the purchase price of new manufacturing and processing machinery purchased for use in Ontario.

**Allowable Business Investment Losses** - Capital losses arising from the sale of shares of Canadian-controlled private corporations may be used to reduce corporate income from any source.

**Small Business Development Corporations Program** - This program entitles investors to receive an Ontario Government grant (for individuals) or a tax credit (for corporations) based on the amount invested in eligible small businesses through an approved Small Business Development Corporation.

**Ontario Mineral Exploration Program** - Junior exploration companies, i.e. non-producing, may receive a tax credit or grant equal to 25 per cent of eligible exploration expenses.

**Resource Allowance** - This provides a tax deduction equal to a percentage of resource profits earned from the production of oil and gas.

### Capital Tax

**Flat Capital Tax for Small Business** - Certain small corporations are either exempt from payment of capital tax or subject to reduced flat rate of tax.

**Farm Equipment Dealers: Capital Tax Reduction** - This provides for a special reduced capital tax for farm equipment dealers for the first two taxation years commencing after December 31, 1986 and before January 1, 1989.

Mining Profits Tax

**Three-Year Mining Profits Tax Exemption for New Mines** - Income earned from a new mine or a major expansion of an existing mine is exempt from mining tax for the first three years of commercial production.

**$500,000 Mining Profits Exemption** - An exemption is provided annually on the first $500,000 of mining income.

## Retail Sales Tax Expenditures
## 1988 Tax Rules

Services

**Professional** - Professional fees are exempt.

**Commercial** - Most commercial services are exempt.

**Personal** - Most personal services are exempt.

**Transient Accommodation** - Transient accommodation is taxed at a reduced rate of 5 per cent.

**Admission Fees** - All admission fees to places of amusement costing $4.00 or less and other specific events are exempt.

Goods

**Energy** - All forms of energy, including motive fuels, are exempt.

**Basic Groceries** - All grocery store food, except soft drinks, snack foods and confections, are exempt from RST.

**Production Machinery** - Production machinery and equipment and subsequent repairs are exempt from RST.

**Reading Materials** - Books, newspapers and magazines purchased by subscription are exempt.

**Prepared Foods** - Prepared food priced at $4 or less is exempt.

**Soil and Water** - Soil, clay, sand, gravel, unfinished stone and natural water are exempt.

**Prescription Drugs** - All drugs prescribed by a doctor, dentist or veterinarian are exempt.

**Children's Clothing** - Children's sized clothing is exempt.

**Aircraft** - Commercial aircraft and parts, equipment and repairs for such aircraft are exempt.

**Footwear** - Footwear priced at $30 or less is exempt.

**Medical Equipment** - Hearing aids and dental and prescription optical appliances are exempt.

**Feminine Hygiene Products** - Tampons, sanitary pads and sanitary belts are exempt.

Purchaser Specific

**Farmers** - Most implements, machinery and repairs, and agricultural products are exempt when purchased by a person engaged in farming.

**Visitors to Ontario** - Out-of-province visitors to Ontario are eligible for a refund of RST paid on certain items.

**Hospitals** - Medical and surgical equipment purchased by a hospital is exempt.

**Religious/Charitable** - Used clothing and/or footwear sold by these organizations for less than $50 and meals sold at a nominal charge are exempt. These organizations' purchases of publications, items used for worship, and construction materials are exempt under certain conditions.

**Disabled Persons** - Most prosthetic and orthopedic devices are exempt. A rebate for RST paid on purchases of vehicles used to transport persons with physical disabilities is available.

**Fishermen** - Certain fishing equipment, including vessels, is exempt when purchased by commercial fishermen.

**Fur-Trappers** - Trapping equipment purchased by a licensed trapper is exempt.

**Museums/Galleries** - Works of art purchased by a museum or art gallery are exempt if more than 50% of the establishment's revenue is provided by public donations or grants.

**Municipalities (fire trucks)** - Fire-fighting vehicles priced at more than $1,000 and purchased for exclusive use of a municipality, public hospital, university, local service board or volunteer group are exempt.

# APPENDIX II

## Health Care Expenditure Profile

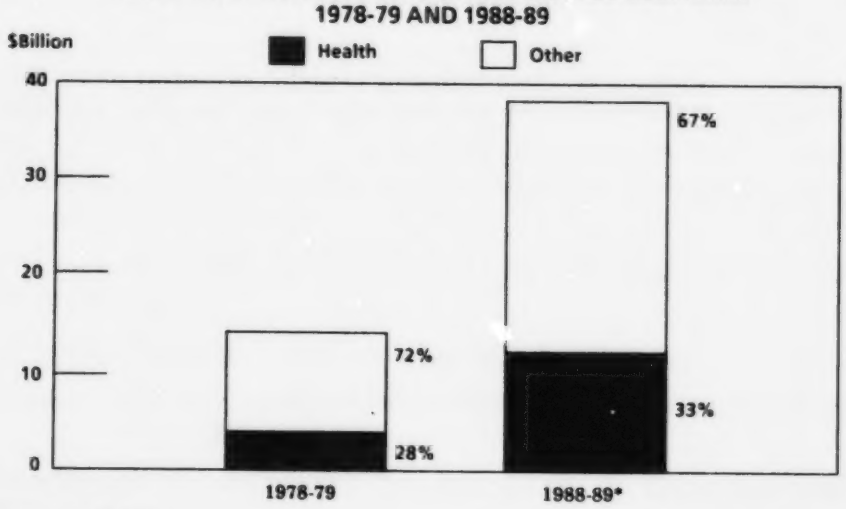
The quality, direction, and in particular the cost of health care services have been the subject of extensive public debate in recent years. This appendix, an update of the paper which originally appeared in the 1988 Ontario Budget, provides an overview of health care expenditures in Ontario between 1978-79 and 1988-89. The major components of the Ministry of Health's expenditures -- the Operation of Hospitals, the Ontario Health Insurance Plan (OHIP), and the Ontario Drug Benefit Plan (ODB) -- are examined.

In this profile, health care expenditures are defined as total expenditure outflows by the Ministry of Health. In addition, the Ministry of Community and Social Services provides health-related programs for the developmentally handicapped and for senior citizens, and the Ministry of Labour is responsible for Occupational Health and Safety legislation. The total cost of these additional health-related programs was approximately $1 billion in 1987-88.

### Health Care Spending

Provincial expenditures on health care grew steadily between 1978-79 and 1988-89, consuming an increasing share of total Government resources. During this period, the share of total expenditure outflows attributable to the Ministry of Health rose from 28 per cent to 33 per cent.

MINISTRY OF HEALTH SHARE OF ONTARIO EXPENDITURES
1978-79 AND 1988-89



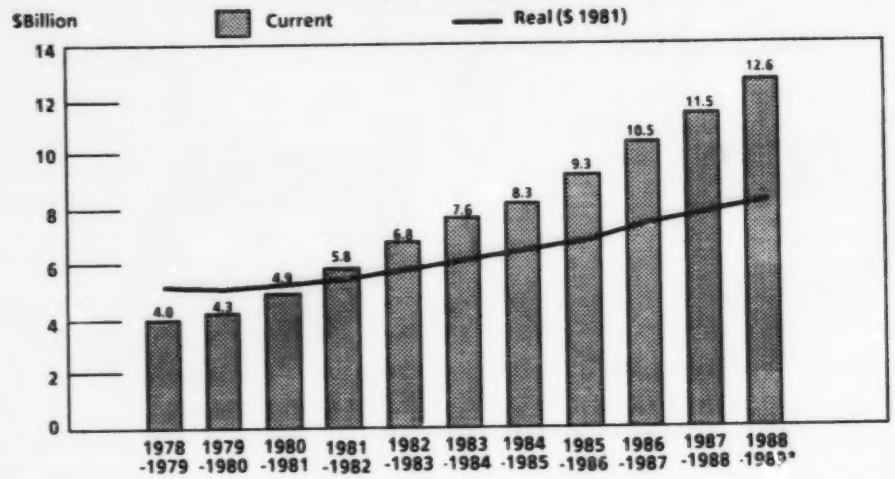

* As of September 30, 1988.

Source: Ontario Ministry of Treasury and Economics.

Health care expenditures have more than tripled in a decade, from $4.0 billion in 1978-79 to an estimated $12.6 billion in 1988-89, an average rate of growth of 12.3 per cent a year. Only about 1.1 per cent of this growth is attributed to population increases. Most of the increase in spending is therefore explained by an average

annual increase in per person spending of 11.0 per cent. Total per person health costs in 1988-89 reached $1,338.

MINISTRY OF HEALTH EXPENDITURES
1978-79 TO 1988-89




* As of September 30, 1988.

Sources: Ontario Ministry of Treasury and Economics and Statistics Canada.

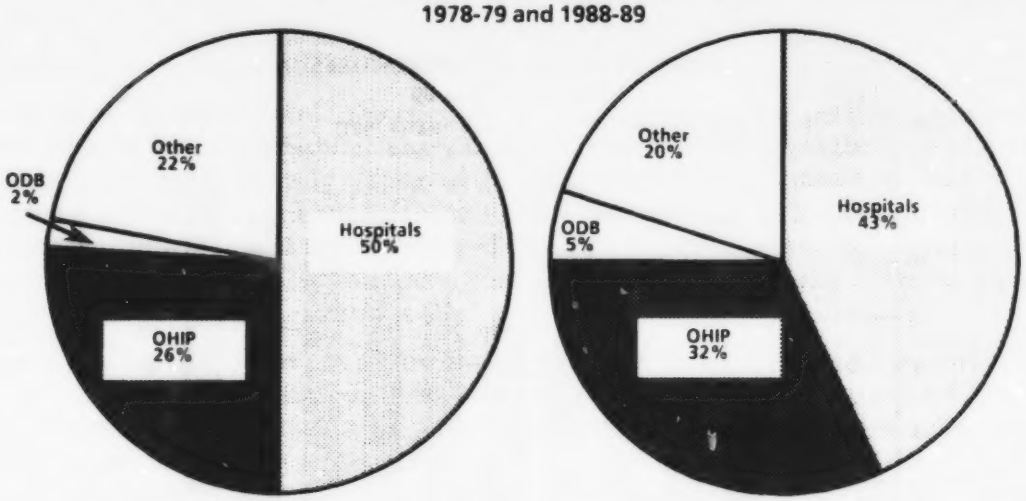
Over most of this period, growth in the health sector outpaced the growth in the Ontario economy. After taking inflation into account, expenditures on health care increased by 63.4 per cent, while Ontario's economy, as measured by real Gross Domestic Product (GDP), grew by 42.7 per cent.

## Key Components of Health Spending

Between 1978-79 and 1988-89, three areas of health services -- the Operation of Hospitals, the Ontario Health Insurance Plan (OHIP), and the Ontario Drug Benefit Plan (ODB) -- represented 78 to 80 per cent of Ministry of Health spending. The remaining expenditures were for such programs as Extended Care, Home Care Assistance, Emergency Health, Mental Health, other health care programs, and for capital requirements.

Changes in the composition of Ministry of Health spending between 1978-79 and 1988-89 are shown in the following chart. As shown, the increase in OHIP's share of health spending, from 26 per cent to 32 per cent, has compressed other areas' shares, most notably the Operation of Hospitals, which declined from 50 per cent to 43 per cent.

**COMPONENTS OF HEALTH CARE SPENDING**
**1978-79 and 1988-89**

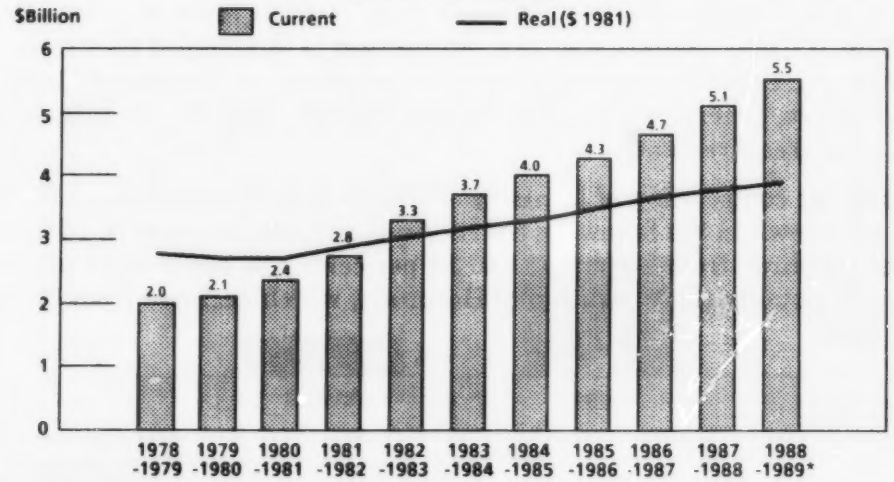



*** As of September 30, 1988.**
Source: Ontario Ministry of Treasury and Economics.

*Operation of Hospitals*

Over the past decade, Provincial expenditures on the Operation of Hospitals increased more than two and one-half times, from $2.0 billion in 1978-79 to $5.5 billion by 1988-89, an average annual increase of 10.7 per cent. On a per capita basis, expenditures for the Operation of Hospitals increased during this period from $234 to $581, an average growth rate of 9.5 per cent a year.

**HOSPITAL OPERATING EXPENDITURES**
**1978-79 TO 1988-89**




*** As of September 30, 1988.**
Sources: Ontario Ministry of Treasury and Economics and Statistics Canada.

Over this period, Provincial funding was provided to recognize factors such as:

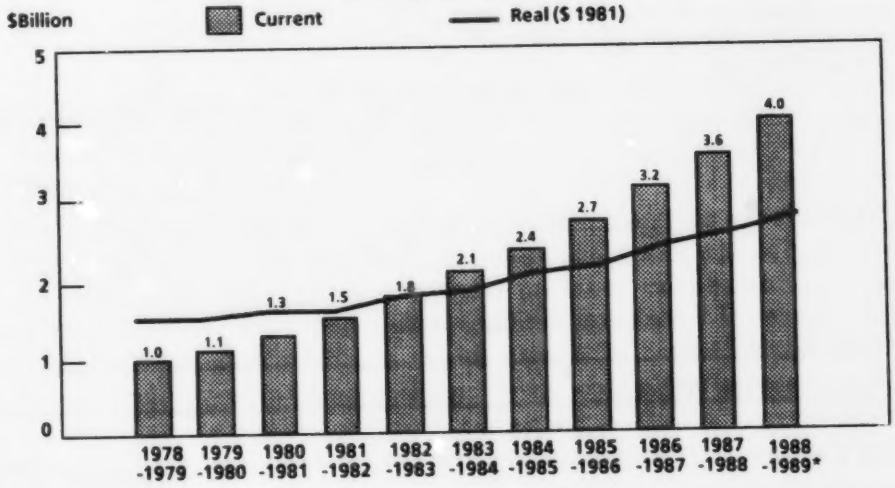
- wage and salary increases;
- more demand for hospital services;
- increased costs of high technology life-support programs; and
- the introduction of new programs and expansion of existing programs.

These hospital expenditures represent funds used solely for operating costs in Ontario's public hospitals and do not include funds for renovation costs or new construction. Over the last five years, more than $1 billion has been spent for hospital capital expenditures.

*Ontario Health Insurance Plan*

Expenditures for OHIP payments to physicians and other practitioners have quadrupled in the past ten years, from $1.0 billion in 1978-79 to $4.0 billion by 1988-89. Annual percentage increases in OHIP expenditures have fluctuated in a range from 9.7 per cent recorded in 1979-80, to a high of 19.7 per cent in 1982-83, averaging 14.7 per cent over the period as a whole. On a per capita basis, OHIP expenditures rose from $121 to $426, an average annual rate of 13.4 per cent over the period.

**OHIP EXPENDITURES**
**1978-79 TO 1988-89**




*** As of September 30, 1988.**

Sources: Ontario Ministry of Treasury and Economics and Statistics Canada.

More recently, for the period from 1981-82 to 1987-88, OHIP expenditures grew from $1.5 billion to $3.6 billion, representing an average annual rate of increase of 15.3 per cent. This consisted of an average negotiated fee increase for laboratory services, physicians and other practitioners of approximately 8 per cent a year and an average utilization increase of 7 per cent a year. Over this period, the trend in negotiated fee increases declined while OHIP utilization rates rose.

Table 1 below shows the growth in the number of Ontario licensed physicians billing OHIP and the average payment per physician from 1981-82 to 1987-88.

**Ontario Licensed Physicians Billing OHIP 1981-82 to 1987-88** **Table 1**

| | Number of Physicians | Per Cent Change | Average OHIP Payments Per Physician ($) | Per Cent Change |
|---|---|---|---|---|
| 1981-82 | 13,478 | 2.6 | 94,500 | 16.8 |
| 1982-83 | 13,888 | 3.0 | 109,000 | 15.3 |
| 1983-84 | 14,429 | 3.9 | 121,100 | 11.1 |
| 1984-85 | 15,039 | 4.2 | 130,500 | 7.8 |
| 1985-86 | 15,698 | 4.4 | 140,700 | 7.8 |
| 1986-87 | 16,443 | 4.7 | 154,100 | 9.5 |
| 1987-88 | 17,156 | 4.3 | 170,800 | 10.8 |

Source: Ontario Ministry of Health.

Another component of OHIP expenditures that has increased significantly in recent years is laboratory services. On average, OHIP payments for laboratory services have increased by 16.1 per cent annually over the period from 1981-82 to 1987-88.

**Growth in Laboratory Services 1981-82 to 1987-88** **Table 2**

| | ($ Million) | Per Cent Change |
|---|---|---|
| 1981-82 | 133.9 | 13.1 |
| 1982-83 | 161.6 | 20.7 |
| 1983-84 | 184.3 | 14.0 |
| 1984-85 | 213.5 | 15.8 |
| 1985-86 | 247.5 | 15.9 |
| 1986-87 | 282.7 | 14.2 |
| 1987-88 (Preliminary) | 327.2 | 15.7 |

Source: Ontario Ministry of Health.

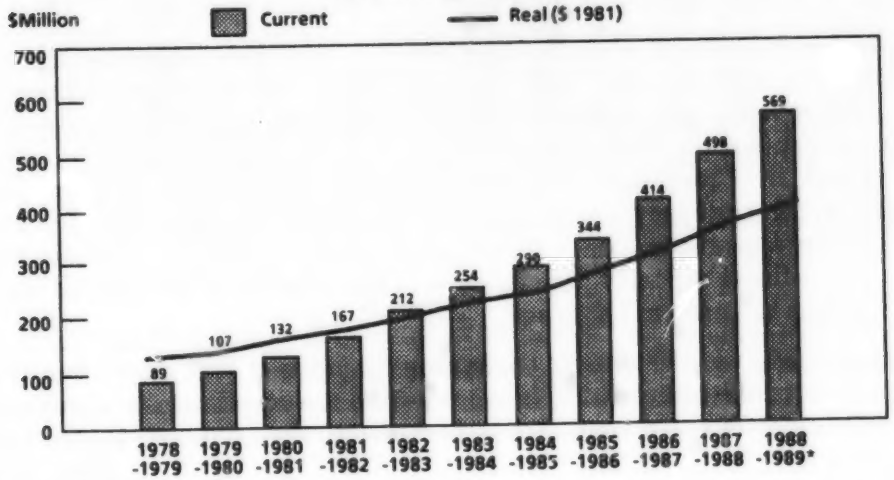
Overall, the number of OHIP claims has increased from 61 million in 1978-79 to an estimated 99 million in 1988-89. The average number of claims per capita rose from 7.2 to 10.5 over this period.

*Ontario Drug Benefit Plan*

The Ontario Drug Benefit Plan (ODB) was established in 1974 to ensure that the cost of prescribed drugs would not be a deterrent to the elderly and to those in need. The program ensures that seniors, social assistance recipients, and residents of extended care facilities and homes for special care receive their prescribed drugs free of charge.

Ministry of Health expenditures on the ODB plan increased from $89 million in 1978-79 to $569 million by 1988-89, an increase of 539 per cent over the period, or an average annual increase of 20.4 per cent. Much of the rate of increase in the earlier years was due to the natural growth within the eligible population. Yet double-digit rates of growth have been sustained throughout the period, making ODB one of the fastest growing health care programs over the period. Average ODB expenditures by the Ministry of Health per claimant have increased from $128 in 1978-79 to an estimated $550 in 1988-89.

**ODB EXPENDITURES**
**1978-79 TO 1988-89**




*** As of September 30, 1988.**

Sources: Ontario Ministry of Treasury and Economics and Statistics Canada.

## Conclusion

Maintaining and improving the health care system requires substantial levels of expenditure. Factors such as the aging structure of Ontario's population have, and are expected to place even greater upward pressure on health care spending. Increases in federal transfer payments under Established Programs Financing (EPF) have not kept pace with the rapid growth in health expenditures. The search for productivity improvements and lower cost alternatives to health care that do not sacrifice the quality of care or reduce accessibility to necessary services must continue. This task requires the cooperative effort of all participants in the health care sector.

# APPENDIX III

## Fiscal Capacity and Tax Effort

Fiscal capacity measures the relative ability of a province to raise revenues from available revenue sources. Tax effort measures the relative extent to which each province taxes those available revenue sources. In this section, these measures are used to make interprovincial comparisons.

### Determination of Fiscal Capacity

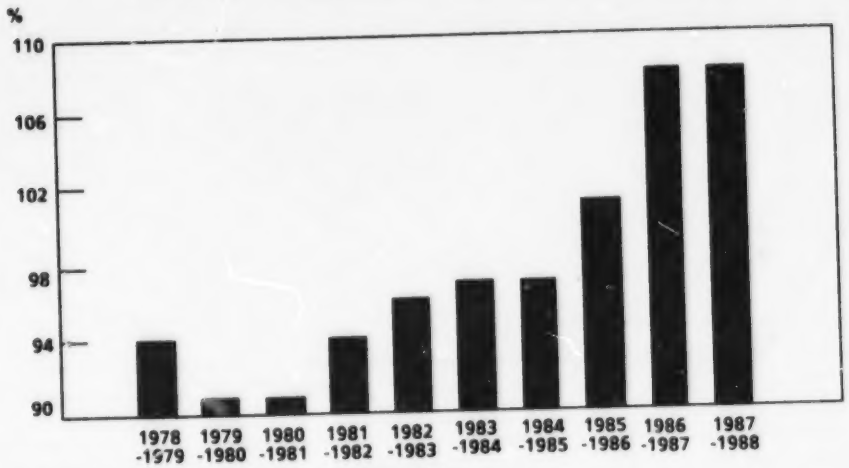
Fiscal capacity can be measured by a number of different indices.

The Representative Tax System (RTS) is the one used by the federal and provincial governments as a measurement of fiscal capacity. In the Representative Tax System, each revenue source has an associated tax base and the fiscal capacity can be related to population. For example, the base for tobacco taxes is the number of cigarettes sold in a province. If a province's share of a base is lower than its population share, that province is said to have a fiscal capacity deficiency in that tax base. If the opposite is true, a fiscal capacity surplus exists. In other words, a province has a fiscal capacity deficiency in a tax base if its per capita share of a base is less than the national average.

Tax bases are defined according to the taxing practices of provinces. For example, if an item such as infants' clothing is exempt from the retail sales tax in a majority of the provinces, such sales would not be included in the tax base. Hence, the term "representative".

Employing data from the federal equalization program, it is possible to derive an aggregate tax base share by "adding" together 37 different provincial and local tax bases. This provides a single but comprehensive measure of a province's relative fiscal capacity. In 1987-88, Ontario's fiscal capacity, measured on this basis for provincial-local own-source revenues, was 108 per cent of the national average. The chart below indicates how Ontario's fiscal capacity has varied over the past ten years.

**FISCAL CAPACITY OF ONTARIO**
**(PER CENT OF NATIONAL AVERAGE FISCAL CAPACITY)**




Notes: Data for 1986-87 and 1987-88 are subject to revision.
Index for 1987-88 is based on the phased-in value of the tax base change in the 1987 Fiscal Arrangments Regulations.

Source: Department of Finance, Canada.

As Table 1 shows, own source fiscal capacities in 1987-88 ranged from 61 per cent for Newfoundland to 144 per cent for Alberta. If federal transfer revenues are added to provincial-local own-source revenues, the fiscal capacity of "equalization-recipient" provinces approaches the national average. Since federal transfers are relatively large for the "equalization-recipient" provinces, the relative fiscal capacities of the "non-recipient" provinces decline. For example, Ontario's 1987-88 fiscal capacity declines 9 percentage points to 99 per cent of the national average, primarily because the Province does not receive federal equalization payments.

**Indices of Provincial-Local Fiscal Capacity, 1987-88** **Table 1**
(Per Cent of National Average)

| | Provincial-Local Own-Source Revenues | Provincial-Local Own-Source Revenues plus All Federal Transfers* |
|---|---|---|
| Newfoundland | 61 | 96 |
| Prince Edward Island | 65 | 96 |
| Nova Scotia | 76 | 94 |
| New Brunswick | 71 | 96 |
| Quebec | 85 | 95 |
| **Ontario** | **108** | **99** |
| Manitoba | 83 | 93 |
| Saskatchewan | 91 | 95 |
| Alberta | 144 | 129 |
| British Columbia | 103 | 98 |
| National Average | 100 | 100 |

* Federal Transfers include federal 1987-88 Main Estimates only.
Note: Data are subject to revision.
Source: Department of Finance, Canada

Included in the determination of federal transfers are special contracting-out tax points that Quebec opted for in lieu of a portion of federal cash contributions under the Canada Assistance Plan and Hospital Insurance. The latter contributions were subsequently rolled into Established Programs Financing.

## Determination of Tax Effort

A comparison of provincial tax rates on individual revenue sources (e.g. sales tax rate) is often employed as a gauge of relative revenue-raising efforts. However, such comparisons alone do not provide a way of assessing a province's overall tax effort.

As with the determination of fiscal capacity, tax effort can be measured by individual revenue sources. For each revenue source, a national average tax rate can be calculated by dividing the provincial revenues collected by the total all-province tax base. A comprehensive measure of tax effort can then be calculated by dividing a province's share of total provincial-local revenues by its share of total tax base.

This measure of tax effort indicates to what extent a province is taxing what is available to be taxed, relative to the national average. Local revenues are included because of the varying responsibilities that individual provinces allocate to their local governments. Table 2 provides the indices of relative tax effort for 1987-88 on this comprehensive basis.

| Indices of Provincial-Local Tax Effort, 1987-88<br>(Per Cent of National Average Tax Effort) | Table 2 |
|---|---|
| Newfoundland | 102 |
| Prince Edward Island | 94 |
| Nova Scotia | 92 |
| New Brunswick | 96 |
| Quebec | 120 |
| **Ontario** | **98** |
| Manitoba | 110 |
| Saskatchewan | 102 |
| Alberta | 76 |
| British Columbia | 96 |
| National Average | 100 |

Note: Data are subject to revision.
Source: Department of Finance, Canada

Ontario's overall tax effort is slightly less than the national average. Alberta's tax effort is about 24 per cent below the national average, mainly because it levies no sales tax and has the lowest personal income tax rates. Since Alberta's share of oil and gas revenues is about the same as its share of oil and gas tax bases, its resource taxation does not bias its tax effort one way or another.

Quebec has a very high tax effort, some 20 percentage points above the national average in 1987-88. Despite high rates of taxation on certain revenue sources, the Maritime provinces do not have a high degree of overall tax effort, due in large part to their relatively low levels of local property taxation.

# APPENDIX IV

## Glossary of Terms

**Ad Valorem Tax** - A percentage-based tax, typically applied to a measure of value such as selling price.

**Basic Federal Tax** - The level of tax determined by applying the federal tax rate schedule to taxable income and subtracting non-refundable credits. It is not federal tax payable, which is basic tax adjusted by credits, surtaxes or reductions. Ontario's tax rate of 51 per cent is applied to Basic Federal Tax to yield Basic Ontario Income Tax.

**Canada Assistance Plan** - Federal-provincial cost-sharing mechanism for provincially-administered social assistance and welfare programs.

**Capacity Utilization Rate** - The ratio of actual output of an industry (plant, firm, or economy) to the output it could produce with its existing plant and equipment.

**Consolidated Public Sector Funded Debt** - Funded debt incurred at all levels of Provincial jurisdiction, including the Province, Ontario Hydro, municipalities, hospitals, universities and colleges.

**Consumer Price Index** - A monthly index measuring the retail prices of a fixed basket of goods and services purchased by consumers.

**Consumption** - The value of spending by consumers on goods and services, measured in current dollar terms (nominal) or adjusted for inflation (real). In Ontario, consumption accounts for approximately 55 per cent of Gross Domestic Product.

**Cost-of-living Adjustment** - An adjustment to incomes, wages or other payments to maintain previous purchasing power in the face of changing consumer prices.

**Debt to Equity Ratio** - The total debt of a corporation divided by its shareholders' total equity.

**Deductions** - Reductions in the income tax base, usually for specific expenses incurred in order to earn income.

**Deficit** - The amount by which expenditures exceed revenues.

**Economies of Scale** - Reductions in the average cost of production achieved by increasing the volume of output.

**Equalization** - Unconditional transfers from the federal government to qualifying provinces with the purpose of ensuring that provincial governments have sufficient revenues to provide reasonably comparable levels of public service at reasonably comparable levels of taxation.

**Established Programs Financing** - Unconditional federal payments to the provinces in respect of health care and post-secondary education.

**Exemptions** - Amounts deductible from income in recognition of specific personal circumstances or, in the case of sales taxes, items specifically excluded from the tax base.

**Expenditures** - Direct expenditures on government programs include payments for goods and services, interest on the public debt, salaries and employee benefits, transfer payments to individuals, municipalities and institutions, subsidies and grants, and the acquisition and construction of fixed assets.

**Export** - A good or service produced in one country or jurisdiction and sold to another.

**Final Demand** - Domestic and foreign purchases of goods and services produced for final use within the economy, excluding inventory change.

**Final Domestic Demand** - Purchases of goods and services for final use within the economy, excluding the foreign sector (exports and imports) and inventory change.

**Fiscal Arrangements** - Institutional vehicles through which the federal government transfers funds to the provinces as part of its commitment to shared-cost programs and interprovincial fiscal capacity equalization.

**Fiscal Capacity** - Measure of a province's ability to raise revenues from available revenue sources relative to other provinces.

**Fiscal Policy** - The use of the Government's spending and taxing power to affect the aggregate level of economic activity. Expansionary fiscal policy is generally characterized by an increase in discretionary spending or a tax cut.

**Fiscal Stabilization** - Unconditional cash transfers from the federal government to ensure that no province's tax revenues, measured on the basis of constant tax rates and structure, plus its equalization payments, will be less than they were in the previous year.

**Funded Debt** - Debt which has a specified term to maturity and is secured by a debt instrument such as a bond.

**Gross Borrowing** - Total borrowing including borrowing necessary for debt retirement purposes.

**Gross Domestic Product (GDP)** - The value of goods and services produced within the geographic boundaries of an area, expressed either in current dollar value (nominal) or adjusted for inflation (real).

**Gross National Product (GNP)** - The value of a nation's total output of goods and services, expressed either in current dollar terms (nominal) or adjusted for inflation (real). The percentage change in real GNP is the usual measure of the real growth rate of the U.S. economy.

**Group of Seven Countries** - Canada, France, Italy, Japan, United Kingdom, United States and West Germany.

**Guaranteed Debt** - Debt for which the Province agrees to meet the costs if the borrowing party can not; primarily for Ontario Hydro.

**Household Formation** - Net increases in new households in a period.

**Import** - A good or service which has been bought from another country or jurisdiction.

**Inflation** - A continuing rise in the general price level.

**Interest Rate** - The price paid (charged) by a borrower (lender) of money. Nominal interest rates are those actually paid; real interest rates are nominal rates less the expected rate of inflation (current rates of inflation are generally used as proxies for expected rates).

**Interest Service Ratio** - Total interest payments taken as a per cent of cash flow of industrial corporations before interest and taxes are deducted.

**Inventory** - The total value of the various raw materials, goods in process, parts and finished goods held by a firm.

**Inventory Accumulation** - An increase in the level of inventories held in the economy.

**Investment** - The value of spending on capital goods such as houses, plant and machinery and equipment; may be measured in current dollar terms (nominal) or adjusted for inflation (real).

**Labour Force** - The total number of persons, age 15 and over, who are either employed or looking for work.

**Marginal Tax Rates** - A schedule of rates used to determine the amount of tax payable at various taxable income levels and on each additional dollar of taxable income.

**Monetary Policy** - The policies of the central bank (Canada - Bank of Canada; U.S. - Federal Reserve Board) that determine the availability and cost of credit (i.e., interest rates) in the economy. Tight (anti-inflationary) monetary policy restricts growth of the money supply, thus raising interest rates and reducing inflation by squeezing demand from the economy.

**Multi-Stage Sales Tax** - A percentage-based tax which applies to the difference between the taxable sales and taxable purchased inputs for each transaction of the production and distribution process, such that only the value added at each stage is taxed.

**Net Borrowing** - Gross borrowing less borrowing needed for debt retirements.

**Net Cash Requirements (NCR)** - The sum of the Deficit and the net balance of Other Transactions.

**Net Migration** - The difference between the total population coming into the province and the total population leaving.

**Nominal (GDP, consumption, investment, etc.)** - Value in current dollars (i.e., not adjusted for inflation).

**Non-Marketable Securities** - Securities which may not be bought or sold in public capital markets.

**Non-Public Borrowing** - Borrowing from non-public sources of funds, usually pension funds like the Canada Pension Plan.

**Operating Position** - The difference between total current revenues and total current expenditures, excluding capital expenditures.

**Organization for Economic Cooperation and Development (OECD)** - An organization of industrial nations, with a permanent staff of officials, established in 1961 to improve trade and investment flows among its members, to help analyze and deal with balance-of-payments and other economic problems and to coordinate foreign-aid policies.

**Other Revenue** - Equals total revenue minus taxation revenue and payments from the federal government. Major sources include OHIP premiums, LCBO and lottery profits, fees and licences and interest income.

**Other Transactions** - The lending, investment and special account administration activities of the Government, including loans, advances and investments, pensions and related benefit funds and special purpose accounts. The transactions affect only assets and liabilities accounts.

**Own-Purpose Debt** - Debt issued by Ontario for Provincial use only. This excludes debt issued by Ontario on behalf of Ontario Hydro.

**Paid-Up Capital** - For most corporations, paid-up capital funds invested in the corporation by its shareholders and other parties, loans or advances made to the corporation, and its cumulative undistributed corporate profit less its investment in other firms.

**Participation Rate** - The percentage of the population age 15 and over that is in the labour force.

**Payroll Tax** - An employment income-based tax, usually a percentage rate, which may be levied on the employer, employee or on both.

**Per Capita** - Per person.

**Per Point Yields** - An estimate of direct revenue which would be gained or lost for a first unit change in tax rates.

**Personal Disposable Income** - The income remaining to persons for consumption or saving after deduction of income taxes and other legislated deductions, such as CPP premiums.

**Personal Income** - The income received by persons from all sources.

**Personal Income Tax Revenue Guarantee** - Federal program to ensure that amendments to the federal Income Tax Act will not reduce a province's personal income tax revenues by more than one per cent, by providing compensation.

**Personal Savings Rate** - Percentage of personal disposable income that is not spent on current consumption.

**Prime Rate** - The interest rate charged by chartered banks to their most credit-worthy customers.

**Productivity** - Output per unit of input (labour, capital, energy) employed.

**Protectionism** - Advocacy of protective tariffs and other barriers to trade as a means of developing national wealth.

**Public Borrowing** - Borrowing which is done through public capital markets.

**Public Debt Interest** - Interest paid by Ontario on total debt incurred for its own purpose.

**Real (GDP, consumption, etc.)** - Adjusted for inflation, constant dollar.

**Recession** - A downturn in the business cycle, characterized by weak economic activity and high unemployment. Two consecutive quarters of decline are generally considered to indicate a recession.

**Recovery** - The upturn of the business cycle following a recession, characterized by an increase in economic activity.

**Representative Tax System** - A series of thirty-seven distinct revenue sources used to determine what provinces, collectively, tax.

**Revenue** - Includes revenue raised through taxation, premiums, fees, licences and permits, payments from the federal government under the Fiscal Arrangements and shared-cost programs and income from investments.

**Seasonal Adjustment (seasonally-adjusted)** - A statistical adjustment to take account of seasonal factors, such as weather, so that data more accurately reflect underlying trends.

**Specific Rate of Tax** - A fixed rate per unit (e.g., gasoline is taxed at a rate of 9.3 cents per litre).

**Surtax** - A tax additional to basic Ontario or basic federal tax, usually calculated with reference to basic tax or to taxable income.

**Tariff** - A tax imposed on imported goods, levied either as a percentage of their value or according to the number of units imported.

**Tax Base** - The taxable value to which tax rates are applied (e.g., the taxable portion of income; or the value of goods and services taxed under the retail sales tax).

**Tax Collection Agreement** - The agreement between each province and the federal government that authorizes the federal government to collect that province's personal income tax. Under the current arrangements, the provinces agree to calculate their tax as a percentage of basic federal tax, effectively waiving all rights to determine the tax base. Provinces are permitted limited credit and surtax/reduction programs. Some provinces have similar arrangements for corporate income taxes.

**Tax Credit** - A reduction of certain taxes paid, with the amount of the credit determined by a specified formula. The Ontario Tax Credits, for example, offset property and sales taxes for individuals by reducing Ontario personal income taxes. The level of this credit is a function of both the amount of tax paid and the ability to pay of the individual. As a result, credit benefits fall as income rises, effectively redistributing tax burdens in favour of lowest income individuals.

**Tax Effort** - Measure of the extent that a province actually taxes available revenue sources relative to other provinces.

**Total Debt** - Funded and unfunded debt borrowed for the Province.

**Unemployment Rate** - The number of persons in the labour market who are unemployed, as a percentage of the labour force; may be either seasonally-adjusted or unadjusted (actual).

**Unfunded Debt** - Debt which is not secured by a debt instrument, such as deposits with the Province of Ontario Savings office.

**Unit Labour Cost** - A measure of productivity calculated by dividing the total wage bill by the total number of units of a good or service produced.

**Value-Added** - The value of a firm's output minus the value of the inputs it purchases from other firms.

## Review of Selected Financial and Economic Statistics
($ million)

| | 1978-79 | 1979-80 | 1980-81 | 1981-82 |
|---|---|---|---|---|
| Revenue | 12,338 | 14,236 | 15,585 | 17,914 |
| Expenditure | 13,924 | 15,357 | 16,882 | 19,694 |
| Deficit | 1,586 | 1,121 | 1,297 | 1,780 |
| Other Transactions (net) | 406 | 537 | 494 | 277 |
| Net Cash Requirements | 1,180 | 584 | 803 | 1,503 |
| **Financial Position** | | | | |
| Total Debt | 16,467 | 18,096 | 19,512 | 21,354 |
| Funded Debt[1] (excluding Ontario Hydro) | 14,038 | 15,196 | 16,215 | 17,592 |
| Provincial Debt Transactions (net) | 1,652 | 1,133 | 968 | 1,363 |
| Gross Domestic Product (GDP) at Market Prices[2] | 92,414 | 104,363 | 114,994 | 131,831 |
| Personal Income[2] | 75,832 | 84,607 | 94,411 | 110,033 |
| Population - June ('000) | 8,440 | 8,501 | 8,570 | 8,625 |
| Funded Debt per Capita (dollars) | 1,663 | 1,788 | 1,892 | 2,040 |
| Personal Income per Capita (dollars) | 8,985 | 9,953 | 11,016 | 12,757 |
| Expenditure as a per cent of GDP | 15.1 | 14.7 | 14.7 | 14.9 |
| Deficit as a per cent of GDP | 1.7 | 1.1 | 1.1 | 1.4 |
| NCR as a per cent of GDP | 1.3 | 0.6 | 0.7 | 1.1 |
| Total Debt as a per cent of GDP | 17.8 | 17.3 | 17.0 | 16.2 |
| Funded Debt as a per cent of GDP | 15.2 | 14.6 | 14.1 | 13.3 |
| Cumulative Net Borrowing for Ontario Hydro | | | | |
| U.S. | 4,141 | 4,506 | 4,379 | 5,573 |
| C.P.P. | – | – | 500 | 1,000 |
| Contingent Liabilities (mainly Ontario Hydro) | 7,096 | 7,904 | 8,553 | 9,284 |

1 Funded Debt includes debentures, notes and Treasury Bills.

2. Gross Domestic Product and Personal Income are calculated on a calendar year basis. The amounts appearing in a fiscal year column are for the preceding calendar year.

3 Ontario Finances, September 30, 1988

Note: All funds are quoted in Canadian dollars.

• Excluding extraordinary adjustments.

N/A - not available.

Source: Ontario Ministry of Treasury and Economics

| 1982-83 | 1983-84 | 1984-85 | 1985-86* | 1986-87 | 1987-88 | Interim 1988-89[3] |
|---|---|---|---|---|---|---|
| 19,367 | 21,412 | 23,893 | 26,240 | 29,544 | 32,453 | 36,273 |
| 22,556 | 24,565 | 26,452 | 28,854 | 32,178 | 34,942 | 37,884 |
| 3,189 | 3,153 | 2,559 | 2,614 | 2,634 | 2,489 | 1,611 |
| 711 | 864 | 857 | 1,009 | 1,286 | 1,203 | 1,129 |
| 2,478 | 2,289 | 1,702 | 1,605 | 1,348 | 1,286 | 482 |
| 23,955 | 27,406 | 30,041 | 32,904 | 35,103 | 36,981 | 38,787 |
| 19,643 | 22,503 | 24,593 | 26,695 | 27,921 | 28,822 | 29,577 |
| 2,051 | 2,860 | 2,090 | 2,102 | 1,194 | 901 | 755 |
| 137,310 | 151,945 | 170,881 | 185,606 | 204,407 | 224,241 | 244,770 |
| 122,443 | 131,947 | 146,006 | 158,552 | 171,221 | 186,628 | 201,524 |
| 8,703 | 8,798 | 8,902 | 9,006 | 9,113 | 9,271 | 9,431 |
| 2,257 | 2,558 | 2,763 | 2,964 | 3,064 | 3,109 | 3,136 |
| 14,069 | 14,997 | 16,403 | 17,605 | 18,789 | 20,130 | 21,368 |
| 16.4 | 16.2 | 15.5 | 15.5 | 15.7 | 15.6 | 15.5 |
| 2.3 | 2.1 | 1.5 | 1.4 | 1.3 | 1.1 | 0.7 |
| 1.8 | 1.5 | 1.0 | 0.9 | 0.7 | 0.6 | 0.2 |
| 17.4 | 18.0 | 17.6 | 17.7 | 17.2 | 16.5 | 15.8 |
| 14.3 | 14.8 | 14.4 | 14.4 | 13.7 | 12.9 | 12.1 |
| 6,058 | 6,487 | 7,206 | 7,189 | 6,667 | 6,033 | N/A |
| 1,000 | 1,000 | 1,000 | 1,000 | 1,119 | 1,508 | N/A |
| 11,122 | 12,711 | 14,220 | 15,963 | 17,603 | 18,595 | N/A |